

No. 15386

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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T. NORMAN PHELPS and ALICE PHELPS,

*Appellants,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Appellee.*

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On Appeal From a Decision by the United States Tax Court.

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## BRIEF FOR APPELLANTS.

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FILED

APR 12 1937

PAUL P. GIBNEY, CLERK.



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**BRIEF FOR APPELLANTS.**

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**Jurisdictional Statement.**

By registered letter mailed on August 19, 1953, pursuant to Section 272 of the Internal Revenue Code of 1939 (26 U. S. C. 272) the Commissioner of Internal Revenue notified appellants of his determination of a deficiency of \$107,926.06 in their Federal income tax for the calendar year 1948. [R. 11.] Thereafter, on November 17, 1953, appellants filed with The Tax Court of the United States their petition for a redetermination of such deficiency [R. 3], and that Court properly assumed jurisdiction over the appeal pursuant to Section 1101 of the Internal Revenue Code of 1939 (26 U. S. C. 1101). On January 5, 1954, the Commissioner of Internal

Revenue filed his answer to appellants' petition and thereafter on September 12, 1955, a hearing was had in the matter before The Tax Court of the United States [R. 4.] Thereafter, on July 31, 1956, The Tax Court of the United States entered its decision in favor of the Commissioner. [R. 44.]

On October 25, 1956, and within the time required by Section 7483 of the Internal Revenue Code of 1954 (26 U. S. C. 7483) appellants filed with the Clerk of The Tax Court of the United States their petition for a review of said decision and served a copy and notice thereof upon the Commissioner of Internal Revenue as required by rule 29 of this Court. [R. 50.]

Appellants' income tax return for the calendar year 1948 was filed with the Collector of Internal Revenue for the 6th District of California whose office was located within the Ninth Judicial Circuit. Jurisdiction of this Court to review the decision of The United States Tax Court therefore exists by virtue of Section 7482 of the Internal Revenue Code of 1954. (26 U. S. C. 7482.)

### **Statement Concerning Exhibits Appearing in Appendix.**

In Appellants' designation of the record material to the consideration of the appeal, Appellants designated all of the exhibits which were attached to the Stipulation of Facts, excepting therefrom only certain pages of Joint Exhibits 9-I through 23-X, but upon receipt of their copies of the Transcript of Record counsel for Appellants noted that none of the exhibits attached to the stipulation

had been printed. Counsel thereupon wrote to the Clerk of the Court, pointing out the omission and the materiality of the exhibits and requesting advice as to the steps to be taken to have such exhibits included in the printed transcript. In reply to their inquiry the Clerk advised counsel that it is not the practice to print exhibits in the interest of economy and that the Court would examine the exhibits without the necessity of reproduction; but stated that if counsel wished they might print as an appendix to their brief the exhibits, or parts of exhibits, which they desired to call to the Court's attention.

Counsel have, therefore, included in the Appendix hereto each of the unprinted exhibits to which reference is made in this brief.

### **Statement of the Case.**

This case presents a single question for decision, namely:

Were the distributions which were made to appellants on December 21, 1948, in redemption of a part of their shares of stock in each of three corporations made at such a time and in such a manner as to be essentially equivalent to taxable dividends within the meaning of Section 115(g) of the Internal Revenue Code of 1939?

Appellants are husband and wife residing in Piedmont, California. They filed a joint income tax return for the year 1948 with the Collector of Internal Revenue for the 6th District of California. [R. 16, 17.]

On April 10, 1946, three corporations, namely Capitol Chevrolet Co., Mid-Valley Chevrolet Co., and Howell Chevrolet Co. were formed and from that date until December 21, 1948, all of the outstanding shares of stock of these corporations were owned as follows:

Shareholder	<u>Capitol Chevrolet Co.</u>	<u>Mid-Valley Chevrolet Co.</u>	<u>Howell Chevrolet Co.</u>
F. Norman Phelps (Appellant herein)	212 shares	213 shares	150 shares
Alice Phelps (Appellant herein)	213 "	212 "	150 "
James A. Kenyon, Trustee of Patricia May Kenyon Trust	170 "	170 "	120 "
J.A.K. Co.	255 "	255 "	180 "
Jackson Howell	—	—	300 "
TOTAL SHARES OUTSTANDING	850	850	900

[R. 17-19]

The Patricia May Kenyon Trust, one of the shareholders in each of the above-named corporations, was a trust which had been created on August 8, 1941 by James A. Kenyon for the benefit of his adopted daughter, Patricia May Kenyon. James A. Kenyon, the creator of this trust, was also the trustee thereof. [R. 17.]

The Patricia May Kenyon Trust was irrevocable and James A. Kenyon, the creator and trustee thereof, had no beneficial interest in the income or corpus thereof other than a remote possibility of reverter. [Jt. Ex. 4-D; Appendix pp. 22-30.]

J. A. K. Co., one of the shareholders in each of the above named corporations, was a corporation all of whose stock was owned by James A. Kenyon individually. J. A. K. Co. was a holding company and the shares of

stock of Capitol Chevrolet Co., Mid-Valley Chevrolet Co. and Howell Chevrolet Co. constituted substantially all of its assets. [R. 24.]

James A. Kenyon, the creator and trustee of the Patricia May Kenyon Trust, was the same James A. Kenyon who owned all of the J. A. K. Co. stock. [R. 180.]

F. Norman Phelps, James A. Kenyon and Alice Phelps were President, Vice-President and Secretary-Treasurer, respectively, of Capitol Chevrolet Co. from the date of its incorporation to December 21, 1948. F. Norman Phelps, Joseph E. Carpenter and James A. Kenyon were President, Vice-President and Secretary-Treasurer, respectively, of Mid-Valley Chevrolet Co. during this same period, and Jackson Howell, F. Norman Phelps and James A. Kenyon were President, Vice-President and Secretary-Treasurer, respectively, of Howell Chevrolet Co. during this same period. [R. 19.]

During the twenty-five year period preceding the formation of the three dealership corporations, appellant F. Norman Phelps had been continuously employed by Chevrolet Motor Division of General Motors Corporation and during that period he had occupied successively the positions of Retail Salesman, Used Car Manager, Sales Manager, District Manager, Office Manager, Assistant Zone Manager, City Sales Manager, Zone Manager, Assistant Regional Manager, and finally Regional Manager for the Pacific Coast Region of Chevrolet Motor Division. [R. 54-55.] James A. Kenyon had practically the same background and experience with Chevrolet Motor Division as did Mr. Phelps [R. 89], and from 1933 through 1944, Jackson Howell had occupied successively the offices of District Manager, Organization Manager of Los Angeles, Assistant Zone Manager of Los Angeles, Branch

Manager in Great Falls, Montana, Branch Manager in Oakland, California, and Assistant Regional Manager at Oakland, California. [R. 205.]

Each of the corporations, Capitol Chevrolet Co., Mid-Valley Chevrolet Co., and Howell Chevrolet Co., was engaged in the business of operating a Chevrolet dealership under a separate "Annual Direct Dealer Selling Agreement" with the Chevrolet Motor Division of the General Motors Corporation. [R. 21.] Each of these dealerships was located within the Pacific Coast Region of Chevrolet Motor Division of General Motors Corporation. [R. 56.]

During the year 1948 the Pacific Coast Region of Chevrolet Motor Division was in the charge of J. L. Connell as Regional Manager thereof. [R. 57, 162.]

During the year 1948 Chevrolet Motor Division of General Motors Corporation established a new policy that no trust or holding company could own an interest in a Chevrolet dealership. [R. 163.] About September 1, 1948 Mr. J. L. Connell, in his capacity as Regional Manager of the Pacific Coast Region of Chevrolet Motor Division, called Mr. F. Norman Phelps to his office and advised him of the establishment of this new policy. Mr. Connell informed Mr. Phelps that steps should be taken to eliminate both the Patricia May Kenyon Trust and J. A. K. Co. from ownership of stock in each of the three dealership corporations and suggested that the elimination of the trust and holding company from such ownership be accomplished in a manner that the proportionate control of Messrs. Phelps, Kenyon and Howell in the three dealerships should remain unchanged. [R. 66, 166, 167.] Mr. Connell's suggestion that the relative control of these three men in the corporations should remain the



same was made as the result of a strictly business decision on his part, as Regional Manager, and arose out of his belief that it was to the best interests of both Chevrolet Motor Division and the dealerships that such relative controls be maintained. [R. 175, 176.]

Based upon his long experience as an employee of Chevrolet Motor Division, and particularly upon his experience as Regional Manager of the Pacific Coast Region, it was Mr. Phelps' firm belief, following his discussion with Mr. Connell that if any one of the three companies, Capitol Chevrolet Co., Mid-Valley Chevrolet Co., or Howell Chevrolet Co., failed to comply with the demand of General Motors that the Trust and holding company be removed from ownership of stock in those corporations, or if they failed to comply with the suggestion of Mr. Connell that such removal be accomplished in such a manner as not to disturb the then existing proportionate control of himself and Mr. Kenyon, then either the franchises of those corporations would not be renewed the next year or they would be cancelled. [R. 76, 77, 85, 86.] He also believed that if such cancellation occurred no other General Motors Corporation franchise would have been offered to, or available to, any of the companies. [R. 90.]

Following his discussion with Mr. Connell, Mr. Phelps informed Mr. Kenyon, who handled the three corporations' financial matters, of his conversation with Mr. Connell regarding what had to be done in complying with the new requirements and suggested that Mr. Kenyon get in touch with Mr. Thomas R. Dempsey, attorney for the three corporations, and ask him to work out some plan by which those requirements could be met. [R. 68, 69.]

Mr. Kenyon and Mr. Dempsey discussed the matter of liquidating J. A. K. Co. in order to comply with Chevrolet

Motor Division's requirements that this holding company be eliminated from ownership in the dealerships, but Mr. Dempsey recommended against such a liquidation during the year 1948 for the reason that such a liquidation would cost Mr. Kenyon from eighty to ninety thousand dollars in taxes, whereas if it were postponed until the Revenue Act of 1949 were passed the liquidation might be accompanied tax free. [R. 182.]

Mr. Kenyon and Mr. Dempsey also discussed ways and means by which the Trust could be removed from ownership of stock in the three corporations in order to comply with Chevrolet Motor Division's requirements. In the course of such discussions they considered the possibility of Mr. Kenyon personally purchasing all of the stock of the three corporations which was owned by the Trust. [R. 181.] Such a purchase, however, was impossible for the reason that Mr. Kenyon's only assets at the time consisted of his stock in J. A. K. Co., a home in Palm Springs and two or three thousand dollars in the bank. [R. 181.] Mr. Kenyon and Mr. Dempsey also considered the possibility of having the three corporations redeem only the Trust shares and then having Mr. Kenyon purchase additional shares from the corporation to equalize the desired proportion; but this could not be done because Mr. Kenyon did not have sufficient cash to make the required purchase. [R. 210-211.]

Following the initial discussions between Mr. Kenyon and Mr. Dempsey and as the result of the problems which developed in the course of such discussions Mr. Phelps, on October 16, 1956, wrote the following letter to Mr. A. W. Strang, the Zone Manager of the Oakland Zone of the Pacific Coast Region of Chevrolet Motor Division, the zone within which the Capitol Chevrolet Co. dealership was located [R. 155]:



“October 16, 1948

“Mr. A. W. Strang

Chevrolet-Oakland

10910 East 14th Street, Oakland 4, California

Dear Art:

Mr. DeLong and I had a conference concerning our situation after the Contracting Meeting here in Sacramento last Monday; then on Wednesday Mr. DeLong called and asked that I give you the information concerning our setup as I gave it to him verbally.

You will remember that previously I informed you we would do anything that Chevrolet Motor Company required concerning our capital structure, and inasmuch as the Division wishes us to eliminate the Trust and the Holding Company, I informed you we would arrange to do this.

As you know, the J. A. K. Co., which is a Nevada Corporation owned by James A. Kenyon, now owns 30 per cent of the stock in Capitol Chevrolet Company, 30 per cent in Mid Valley Chevrolet, and 20 per cent in Howell Chevrolet. Our attorney advises that if this J. A. K. Co. were to be liquidated at the present time, the tax situation is such that Mr. Kenyon and I would be subject to approximately \$90,000.00 tax.

It would seem that if it were possible for you to permit us to postpone the change until the Revenue Act of 1949 passes both the House and the Senate, it would be most helpful to us.

Also, the complications would be the same in the separation of the Center Chevrolet at Colton from Mid Valley Chevrolet in San Bernardino.

So in both instances it unquestionably would work a hardship on us to make the changes at the present time—and if at all possible we would like to wait and see if this new tax bill is passed. It is my understanding that it passed the House at the last session, but was buried in the Senate due to the great number of Bills in the closing days of the session.

At the present time we are working on a way to buy out the Trust by the different corporations. We believe this can be handled because although it is an irrevocable Trust, Mr. Kenyon has jurisdiction over the Trust until his daughter becomes of age.

In eliminating both the Trust and the Holding Company, it may be necessary to reduce our Net Working Capital substantially, and this might result in our being undercapitalized according to the established standard requirements.

We will give you a detailed report as to just what we would like to do in the very near future, at which time I will come to your office and explain the entire transaction in detail. I would appreciate very much having Mr. Connell sit in on this discussion because, as you know, the deals in Southern California are also involved.

Because of the complications, I would appreciate Chevrolet Motor Division giving us six months or a year to work out of the seeming difficulties with which we are faced at the present time.

Very truly yours,

F. Norman Phelps, President

cc—Mr. J. L. Connell, Mr. Gus Culbertson,

Mr. J. A. Kenyon

FNP:ns.”

In addition to writing the foregoing letter Mr. Phelps also discussed the matter with Mr. J. L. Connell, the Regional Manager, and asked him whether or not it would be satisfactory if the liquidation of J. A. K. Co. were delayed until the new law was passed [R. 74], and it was agreed by Mr. Connell that some extension would be given. [R. 166.]

On November 1, 1948, concurrently with the delivery of each of the three corporations of the new "Annual Direct Dealer Selling Agreement" for the period commencing on that date, each of the corporations received two letters from Chevrolet Motor Division. One of these letters notified the company that its operations were unsatisfactory in that all or a part of the ownership in the dealership was held by a trust and the other of the letters advised the company that its operations were unsatisfactory in that all or a part of the ownership in the dealership was held by a holding company. [R. 143-152.] These letters were sent by Chevrolet Motor Division in conformance with its new policy above mentioned. [R. 164.]

If the companies had failed to comply with the requirements set forth in the letters of Chevrolet Motor Division dated November 1, 1948, they would have been sent another letter in which they would be told a new Selling Agreement was not being offered because they were not complying with the policy of the company. [R. 168.]

The plan which was finally adopted to meet the requirements of Chevrolet Motor Division with respect to the elimination of the Trust as a shareholder in the three corporations was one formulated by Mr. Dempsey, the attorney for the three corporations. [R. 71.] Mr. Phelps

had no knowledge of the details of this plan prior to the time when Mr. Dempsey sent him proposed minutes to be adopted at meetings of the Board of Directors of the three corporations [R. 71] and Mr. Jackson Howell, the owner of one-third of the stock of Howell Chevrolet Co. had no knowledge of the details of the plan until after it had been adopted. [R. 210.] Mr. Howell did not vote and did not have an opportunity to vote on the adoption of the plan. [R. 210.]

The plan which was formulated by Mr. Dempsey and finally adopted had two separate steps:

**Step 1.**

(a) The purchase by each of the respective corporations from the Trust of the maximum possible number of its Trust-owned shares, and

(b) The purchase by each of the respective corporations from F. Norman Phelps and Alice Phelps, and the purchase by Howell Chevrolet Co. from Jackson Howell, of such a number of shares that, after the accomplishment of Step 2, the Phelps-Kenyon\* control in Capitol Chevrolet Co. would remain at 50% each and the Phelps-Kenyon\*-Howell control in Howell Chevrolet Co. would remain at 33⅓%. (\*Through J. A. K. Co.)

**Step 2.**

The purchase by James Kenyon, personally, of the balance of shares owned by the Trust in each of the three corporations which were not to be purchased in Step 1.

The second step in the plan was expressly conditioned on the ability of Mr. James Kenyon to secure court authority for his purchase of the stock from the Trust;

and, as an alternative to be used in the event the Court should fail to authorize such purchase, the plan provided that each of the three companies would purchase the balance of its shares which were owned by the Trust. [Jt. Exs. 5-E, 6-F, 7-G; Appendix pp. 31-48.]

The plan formulated by Mr. Dempsey did not call for the purchase by the three corporations of all of the stock held by the Trust in those corporations for the reason that if the purchase of all of the Trust's shares, and the purchase of the required corresponding number of Phelps and Howell shares, had been made by the corporations they would not have had sufficient net working capital left to comply with the Capital Standards requirements of Chevrolet Motor Division. [R. 182.]

Step 1 of the plan was consummated on December 21, 1948, when the three corporations, pursuant to resolutions of their respective boards of directors adopted on that day, distributed the following amounts of money to the following shareholders, respectively, in redemption of the number of their shares shown, to-wit [R. 19-20]:

*Capitol Chevrolet Co.*

<u>Shareholder</u>	<u>Amount Distributed</u>	<u>Shares Redeemed</u>
F. Norman Phelps	\$37,759.15	65
Alice Phelps	37,759.15	65
Patricia May Kenyon Trust	75,518.30	130

*Mid-Valley Chevrolet Co.*

F. Norman Phelps	37,170.25	65
Alice Phelps	37,170.25	65
Patricia May Kenyon Trust	73,340.50	130

*Howell Chevrolet Co.*

F. Norman Phelps	\$23,254.00	50
Alice Phelps	23,254.00	50
Patricia May Kenyon Trust	46,508.00	100
Jackson Howell	46,508.00	100

The consummation of Step 2 of the plan was commenced on June 1, 1949, by the filing by James A. Kenyon, as Trustee of the Patricia May Kenyon Trust, of a petition to the Superior Court of the State of California, in and for the County of Los Angeles, for an order to sell the remaining trust shares in the three corporations to himself as an individual. Proceedings in this action were continued until July, 1950, when the need for the order prayed for in the petition disappeared by reason of the sales of the remaining Trust stock in Capital Chevrolet Co. and Howell Chevrolet Co. to those corporations, respectively, and by the liquidation of Mid-Valley Chevrolet Co. [R. 21, 22.]

Neither Mr. nor Mrs. Phelps had any need for the money which was distributed to them in the redemption of their shares of stock in the three corporations; Mr. Phelps did not at any time request Mr. Dempsey to draw the plan for the elimination of the trust stock in such a manner that he or Mrs. Phelps would receive any cash or property out of the corporations or any of them; and Mr. Phelps at no time suggested to Mr. Dempsey that it would be a desirable feature of any plan which might be devised by him that either he or Mrs. Phelps would receive any cash or property from any of the corporations. [R. 77-78.]

Mr. Howell had no personal desire to draw any money from Howell Chevrolet Co. in excess of that which he drew as compensation, and it was his opinion that the withdrawal of funds from the Howell Chevrolet Co. in the manner in which it was taken out placed a hardship on the operations of the company because it made it necessary for the company to borrow money on its inventories. [R. 209.]



The three corporations' Capital Standards Agreements with Chevrolet Motor Division required them to attain by August 15, 1948, and maintain thereafter, Owned Net Working Capital in the amount of \$261,034.00 and Total Owned Capital in the amount of \$300,533.00. Failure to comply with these requirements constituted grounds for terminating their Chevrolet selling agreements. [R. 139.]

The amounts of Owned Net Working Capital and Total Owned Capital of the three corporations on the thirty-first day of December of the years 1946, 1947 and 1948 were, respectively, as follows:

<u>Corporation</u>	<u>Owned Net Working Capital</u>	<u>Total Owned Capital</u>
<i>December 31, 1946</i>		
Capitol Chevrolet Co.	\$130,207.19	\$160,299.01
Mid-Valley Chevrolet Co.	136,878.63	161,852.62
Howell Chevrolet Co.	106,419.84	154,342.56
[Jt. Exs. 19-T, p. 5; 14-N, p. 7; 9-I, p. 6; Appx. pp. 55; 52; 49]		
<i>December 31, 1947</i>		
Capitol Chevrolet Co.	284,993.47	325,856.62
Mid-Valley Chevrolet Co.	249,240.01	310,853.04
Howell Chevrolet Co.	161,890.95	287,643.74
[Jt. Exs. 20-U, p. 7; 15-O, p. 10; 10-J, p. 7; Appx. pp. 56; 53; 50]		
<i>December 31, 1948</i>		
Capitol Chevrolet Co.	281,782.24	344,666.90
Mid-Valley Chevrolet Co.	219,320.71	334,536.12
Howell Chevrolet Co.	199,773.96	283,970.73
[Jt. Exs. 21-V, p. 7; 16-P, p. 11; 11-K, p. 6; Appx. pp. 57; 54; 51]		

None of the three corporations paid any dividends to their shareholders during the period from the date of incorporation, April 10, 1946, to December 21, 1948. [R. 21.]

On their joint return for the calendar year ended December 31, 1948, appellants reported the amounts received by them from Capitol Chevrolet Co., Mid-Valley Chevrolet Co. and Howell Chevrolet Co. in the redemption of their shares in those companies which had taken place on December 21, 1948, as amounts received from the sale or exchange of such shares and computed their taxes thereon in accordance with the provision of Section 115(c) of the Internal Revenue Code of 1939. In his notice of determination of the deficiency asserted against appellants for the year 1948 the Commissioner of Internal Revenue determined that the amounts so received by appellants were taxable as dividends under Section 115(g) of the Internal Revenue Code of 1939. This determination was affirmed by The Tax Court of the United States in the decision below.

### **Specification of Errors.**

1. The Tax Court of the United States erred in making the following finding of fact:

“Because of the fact that the shares of other stockholders were redeemed along with the trust shares, the capital of the corporations fell below the standards set by Chevrolet.” [R. 39.]

This finding is unsupported by any evidence and is directly contrary to the evidence in the case of Capitol Chevrolet Co.; it is supported, in part only, by the evidence and is, in part, directly contrary to the evidence in the case of Mid-Valley Chevrolet Co.; and is wholly supported by the evidence only in the case of Howell Chevrolet Co. However, even to the extent that the finding is supported in form by the evidence, it is unsupported in substance because of the circumstances of the case.



2. The Tax Court of the United States erred in finding that the distributions made by the three corporations, Capitol Chevrolet Co., Mid-Valley Chevrolet Co. and Howell Chevrolet Co. to appellants on December 21, 1948, in redemption of a part of appellants' shares in each of such corporations were made at such time and in such manner as to be substantially equivalent to distributions of taxable dividends which are to be treated as taxable dividends as provided in Section 115(g) of the Internal Revenue Code of 1939.

3. The Tax Court of the United States erred in failing to find that the distributions in redemption of a part of appellants' shares in each of the three corporations, Capitol Chevrolet Co., Mid-Valley Chevrolet Co. and Howell Chevrolet Co. which were made on December 21, 1948, were not made at such time or in such a manner as to be substantially equivalent to distributions of taxable dividends.

4. The Tax Court of the United States erred in failing to find that the amount received by each of the appellants from each of the three corporations, Capitol Chevrolet Co., Mid-Valley Chevrolet Co. and Howell Chevrolet Co., upon the redemption of their shares of stock in such corporations on December 21, 1948, constituted an amount received in partial liquidation of the respective corporation which is to be treated as in part or full payment in exchange for such corporation's shares as provided in Section 115(c) of the Internal Revenue Code of 1939.

5. The Tax Court of the United States erred in finding that there is a deficiency in appellants' federal income taxes for the year 1948 in the amount of \$107,926.06.

## Summary of Argument.

### POINT I.

The Tax Court committed prejudicial error in finding as a fact that because of the fact that the shares of other stockholders were redeemed along with the trust shares, the capital of the corporations fell below the standards set by Chevrolet and made the corporations' dealership franchises subject to cancellation for cause.

### POINT II.

The distributions to appellants in redemption of a part of their shares in each of the three corporations were not essentially equivalent to distributions of taxable dividends for the reasons: (a) that the distributions were not made pro rata to all shareholders, (b) that the sole purpose of the distributions was a legitimate corporate purpose, and (c) the net effect of such distributions was entirely different from that of taxable dividends.

### POINT III.

The distributions to appellants in redemption of a part of their shares in each of the three corporations constituted amounts distributed in partial liquidation of the corporations and were properly reported by appellants on their return for the year 1948.

## POINT I.

The Tax Court Committed Prejudicial Error in Finding as a Fact That Because of the Fact That the Shares of Other Stockholders Were Redeemed Along With the Trust Shares, the Capital of the Corporations Fell Below the Standards Set by Chevrolet and Made the Corporations' Dealership Franchises Subject to Cancellation for Cause.

The finding of which counsel for Appellants complain is as follows:

"If only the shares of the trust had been redeemed by the three corporations, their capital would not have fallen below the capital standard requirements set by Chevrolet.

"Because of the fact that the shares of other stockholders were redeemed along with the trust shares, the capital of the corporations fell below the standards set by Chevrolet. The additional cash distributions to the other stockholders placed a hardship on the corporations by requiring them to borrow funds. Failure to meet the capital standard requirements is reason for termination of a dealer's franchise." [R. 39.]

Each of the three corporations was a party to a Capital Standards Agreement with Chevrolet Motor Division which required it to attain by August 15, 1948, and maintain thereafter Owned Net Working Capital and Total Owned Capital in the following amounts [R. 139]:

<i>Owned Net Working Capital</i>	<i>Total Owned Capital</i>
<hr/>	<hr/>
\$261,034.00	\$300,533.00

Under the Capital Standards Agreement Owned Net Working Capital was defined as being the excess of total current assets (cash, receivables, cars, parts, accessories,

prepaid expenses and all other inventories) over liabilities, and Total Owned Capital was defined as being Owned Net Working Capital plus fixed and deferred assets. [R. 138, 139.]

On December 31, 1948, and following the redemptions in question the respective Owned Net Working Capital and Total Owned Capital of the three corporations were as follows:

	Capitol Chevrolet Co. [Jt. Ex. 21-V, Appx. p. 57]	Mid-Valley Chevrolet Co. [Jt. Ex. 16-P, Appx. p. 54]	Howell Chevrolet Co. [Jt. Ex. 11-K, Appx. p. 51]
Cash	\$ 97,423.07	102,709.91	114,751.66
Receivables	242,157.67	157,734.44	160,264.68
Inventories	256,541.90	209,413.26	144,942.41
Total Current Assets	\$595,122.64	469,857.61	419,958.75
Liabilities	314,340.40	250,536.90	220,184.79
Owned Net Working Capital	281,782.24	219,320.71	199,773.96
Fixed and Deferred Assets	62,884.66	115,215.41	84,196.77
Total Owned Capital	344,666.90	334,536.12	283,970.73

From the foregoing it is seen that the redemptions did not cause either the Owned Net Working Capital or the Total Owned Capital of Capitol Chevrolet Co. to fall below its standards as set by Chevrolet, hence as to this corporation the Tax Court's finding is pure error.

It will also be seen that the redemptions did not cause Mid-Valley Chevrolet Co. to fall below its Total Owned Capital requirements. The redemptions did, however, cause the Owned Net Working Capital of that corporation to fall below the Owned Net Working Capital standard set by Chevrolet.

The redemptions did cause the Total Owned Capital of Howell Chevrolet Co. to fall some \$16,500.00 below the standard set by Chevrolet and also caused the Owned Net Working Capital of that corporation to fall substantially below the Owned Net Working Capital standard set by Chevrolet.

It is respectfully submitted, however, that even in the cases of Mid-Valley Chevrolet Co. and Howell Chevrolet Co. there was no justification for The Tax Court's finding that their falls below the standards set by Chevrolet were grounds for termination of their franchises for the reason that Chevrolet Motor Division had been advised by letter from Mr. Phelps on October 18, 1948, that in eliminating the Trust and the holding company from ownership in the corporation "it may be necessary to reduce our Net Working Capital substantially, and this might result in our being under-capitalized according to the established standard requirements" and had been requested to grant to the corporation a period of six months or a year to work out of their difficulties [R. 155]; and Mr. Connell, the Regional Manager of the Pacific Coast Region of Chevrolet Motor Division had agreed that some extension would be given. [R. 166.]

Under the circumstances it is clear that the deficits in Owned Net Working Capital of Mid-Valley and Howell Chevrolet Co. and the relatively small (5.5%) deficit in the Total Owned Capital of Howell Chevrolet Co. did not violate these corporations' agreements with Chevrolet and that The Tax Court clearly erred in so finding.

It is respectfully submitted, further, that this erroneous finding constitutes prejudicial error for the reason that it forms the only basis for the unstated, but nevertheless implied, conclusion of The Tax Court that the redemptions



in question were not made for the purpose of preserving the corporations' Chevrolet franchises, but for a stockholder purpose which was accomplished at the risk of losing such franchises.

## POINT II.

**The Distributions to Appellants in Redemption of a Part of Their Shares in Each of the Three Corporations Were Not Essentially Equivalent to Distributions of Taxable Dividends for the Reasons: (A) That the Distributions Were Not Made Pro Rata to All Shareholders, (B) That the Sole Purpose of the Distributions Was a Legitimate Corporate Purpose, and (C) the Net Effect of Such Distributions Was Entirely Different From That of Taxable Dividends.**

The statutory provision applicable to this phase of Appellants' argument is Section 115(g) of the Internal Revenue Code of 1939 which provides as follows:

“(g) Redemption of Stock—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.”

In the case of *Earle v. Woodlaw*, Docket No. 15062 of this Court, which was decided on February 28, 1957 and is not yet published, this Court adopted the “judicial criteria” laid down in the case of *Flanagan v. Helvering*,

116 F. 2d 1937, as the factors which are to be considered in reaching a conclusion as to whether or not Section 115(g) is applicable in a given situation. These criteria as set out by the Court in its decision are as follows:

“1. Did the corporation adopt any plan or policy of contraction of its business activities?

“2. Did the corporation follow an orderly procedure looking toward its ultimate dissolution, or its ultimate contracted operation?

“3. Did the initiative for the corporate distribution come from the corporation, based on usual business considerations, or did it come from stockholders, (or a stockholder), for their (or his) own purpose?

“4. Is the proportionate ownership of stock by the shareholders changed?

“5. What were the amounts, the frequency and the significance of dividends paid in the past?

“6. Does the capitalization, at the time of cancellation of the stock, represent capital paid in, or earnings from the business?

“7. Was there a sufficient accumulation of earned surplus to cover the distribution, or was it partly from capital?

“8. Was there a maintenance of a relatively similar amount of capital liability, or did that figure decrease to a degree somewhat comparable to the purported distribution of capital?

“9. Was there good faith, or bad, in the action of the Board of Directors?

“10. What was the net effect of actions taken?

“This last criteria is that of most importance.”

Applying the foregoing tests to the case at bar we find the following:

1. DID THE CORPORATION ADOPT ANY PLAN OR POLICY OF CONTRACTION OF ITS BUSINESS ACTIVITIES?

ANSWER: No. Furthermore, not only did the corporations not adopt any plan for the contraction of their businesses, but also there was no intent to contract and each of the corporations hoped, expected to, and did continue to grow notwithstanding the temporary setback occasioned by the reductions in their capital resulting from the distributions which were made.

2. DID THE CORPORATION FOLLOW AN ORDERLY PROCEDURE LOOKING TOWARD ITS ULTIMATE DISSOLUTION, OR ITS ULTIMATE CONTRACTED OPERATION?

ANSWER: No, because ultimate dissolution or ultimate contracted operations were never contemplated.

3. DID THE INITIATIVE FOR THE CORPORATE DISTRIBUTION COME FROM THE CORPORATION, BASED ON USUAL BUSINESS CONSIDERATIONS, OR DID IT COME FROM STOCKHOLDERS, (OR A STOCKHOLDER), FOR THEIR (OR HIS) OWN PURPOSE?

ANSWER: The initiative for the distributions in the case at bar came solely from the corporations based upon the most important of all business considerations—the preservation of their Chevrolet franchises.

Nowhere in the record is there the slightest suggestion of stockholder initiative and the record is clear that the initiative *did not* come from either of the appellants herein or from Jackson Howell, the other individual shareholder who received a distribution. The evidence supporting this



statement is found in the following testimony of F. Norman Phelps:

“Q. In December, 1948, did you have any need for the money which you received from Capitol Chevrolet Co., Mid-Valley Chevrolet Co., and Howell Chevrolet Co. upon the redemption by those companies of a portion of your stock? A. Did I have any need for it? No particular need, no.

Q. Do you know of your own knowledge whether or not Mrs. Phelps had any need for the money received by her? A. She did not.

Q. In your discussion with Mr. Dempsey concerning the plan to remove the Trust and the holding company from the dealerships, did you ever request that the plan be so drawn that you would receive any cash or property out of the corporations or any of them? A. I did not.

Q. Did you at any time suggest to Mr. Dempsey that it would be a desirable feature of any plan which might be devised by him that you and Mrs. Phelps, or either of you, receive any cash or property from any of the corporations? A. I did not.” [R. 77-78.]

and in the following testimony of Jackson Howell:

“Q. Mr. Howell, what part did you play in this redetermination of stock? Did you play any personal part? A. No, I did not. Let me understand it. What do you mean?

Q. In the formulating of the plans or the manner in which it was accomplished. A. No, I did not. As I mentioned, the first I knew about it was after the die was cast. I was told to issue the checks.

Q. After the plan had been adopted? A. Subsequently.

Q. You did not vote yes or no yourself or have an opportunity to vote? A. No, I did not.” [R. 210.]

In connection with a consideration of this test it should be noted that The Tax Court, instead of basing its decision on the “business considerations” affecting the three corporations which made the distributions, based the decision on the fact that there was no policy of Chevrolet Motor Division which required the redemptions, stating:

“. . . It is no answer to say that these transactions had their origin in the demand of Chevrolet that the trust be eliminated as a stockholder. That objective could have been achieved, and indeed with less strain upon the corporations, merely by redeeming the shares of the trust. However, Kenyon did not wish to have his control diluted, and Connell, the regional manager for Chevrolet, had himself suggested to Phelps that it would be fair to preserve the same ratios of control. But that suggestion did not represent Chevrolet policy, and we do not believe, on the evidence, that Phelps regarded it as such. It was an objective that the parties themselves would undoubtedly have desired to attain, wholly apart from any suggestion emanating from Connell. Certainly, petitioners, who have the burden of proof, have not shown otherwise . . .” [R. 42, 43.]

Counsel for Appellants submit that the Court’s finding that “we do not believe, on the evidence, that Phelps regarded” Connell’s suggestion as representing Chevrolet policy is wholly unsupported by the record since there is no evidence in the record, other than the incompetent testimony of Mr. Connell upon which the Court states that it did not rely, from which such a finding could be made.

However, conceding for the purpose of argument only that Mr. Phelps did not regard Mr. Connell’s “suggestion”

relative to the maintenance of Mr. Kenyon's controls in the three corporations as representing Chevrolet policy, that does not make the suggestion itself any the less a valid "business consideration" for what was done.

The record is conclusive that the "suggestion" of Mr. Connell was made by him in his capacity as Regional Manager of the Pacific Coast Region of Chevrolet Motor Division. [R. 155-157.] Coming from him in that capacity the suggestion was that of Chevrolet Motor Division, and the record is likewise conclusive that Mr. Phelps, who had personal knowledge of other Chevrolet dealerships being cancelled for failure to comply with suggestions of Chevrolet Motor Division [R. 82], believed that unless such suggestion were complied with the three corporations' franchises either would not be renewed the following year or would be cancelled. [R. 77.] Mr. Phelps, who had been an employee of Chevrolet Motor Division for twenty-five years prior to the formation of the three corporations, had a very fundamental viewpoint concerning "suggestions" coming from that Division which is clearly shown by the following testimony:

"Q. Can you, based upon extensive experience, give me any synonyms that you think mean the same thing from your experience with the word 'suggestion' or 'request' as it relates to a request or a suggestion from the Chevrolet Motor Division to a dealer? A. I don't know about a synonym, but it is hard to explain. If Chevrolet Motor Division suggests that you do something, the dealer assumes that they want it done, and they do it. They just do not want to take any chances. That's the

whole thing. I don't think it is a command or anything of the kind, but the dealer takes it as such." [R. 84, 85.]

In determining whether or not a valid "business consideration" existed for maintaining Mr. Kenyon's relative controls in the three corporations by means of the redemptions which were made, does it make any difference whether Mr. Phelps', and through him the dealerships', fears of losing their franchises were based on knowledge that the control requirement emanated from Chevrolet policy, or merely wishes, or even a mere whim of the Regional Manager, *so long as those fears were real?* Obviously it does not; and equally obviously the finding of The Tax Court above quoted is not germane to the question to be decided.

The proper question of fact upon which The Tax Court should have made its finding was whether or not Mr. Phelps believed that the three corporations' Chevrolet franchises were in danger of being lost if the corporations had failed to comply with Mr. Connell's suggestion that Mr. Kenyon's control in the three corporations be not changed, and the only finding which the Court could have made on that question would have come from the following testimony of Mr. Phelps:

"Q. (By Mr. Thayer): Based upon your experience as an employee of the Chevrolet Motor Division, particularly your experience as Regional Manager of the Pacific Coast Region, did you have a belief in 1948 as to the consequences to the three dealerships, (Capitol Chevrolet Co., Mid-Valley Chevrolet Co., and Howell Chevrolet Co. of their

failure to comply with the suggestion of Mr. J. L. Connell that the Trust and holding company be removed from ownership of stock in such dealerships in such a manner as not to disturb the then existing proportionate control of yourself and Mr. Kenyon in those corporations?

Mr. Townsend: Would you just answer that yes or no, Mr. Phelps?

The Witness: Yes, I did.

\* \* \* \* \*

The Witness: My belief was that over a period of years that when Chevrolet makes a suggestion that you comply with that suggestion, and I assumed that Mr. Connell wanted to leave everything exactly the same as it was, because we were going along pretty well on an equal basis, Mr. Kenyon and myself particularly; and as far as any dealer doing other than what Chevrolet wants them to do, they just don't do it.

Q. (By Mr. Thayer): What was your belief as to the effect upon the dealerships of their failure to comply with these suggestions? A. It was my firm belief that unless we complied with Chevrolet's demands and requests that either our franchise would not be renewed next year or our franchise would have been cancelled, because we were going against a direct policy of theirs. That is the only reason we did it.

Q. Did you have that belief in 1948? A. Yes."  
[R. 75-77.]

4. IS THE PROPORTIONATE OWNERSHIP OF STOCK BY THE SHAREHOLDERS CHANGED?

ANSWER: Yes. Such change is clearly shown by the following table of stock ownership percentages before and after the distributions:

<u>Stockholder</u>	<u>Percentage Ownership Before Distribution</u>	<u>Percentage Ownership After Distribution</u>
<i>Capitol Chevrolet Co.</i>		
F. Norman Phelps	24.94	24.92
Alice Phelps	25.06	25.08
Patricia May Kenyon Trust	20.00	6.78
J. A. K. Co.	30.00	43.22
<i>Mid-Valley Chevrolet Co.</i>		
F. Norman Phelps	25.06	25.08
Alice Phelps	24.94	24.92
Patricia May Kenyon Trust	20.00	6.78
J. A. K. Co.	30.00	43.22
<i>Howell Chevrolet Co.</i>		
F. Norman Phelps	16.67	16.67
Alice Phelps	16.67	16.67
Patricia May Kenyon Trust	13.33	3.33
J. A. K. Co.	20.00	30.00
Jackson Howell	33.33	33.33

5. WHAT WERE THE AMOUNTS, THE FREQUENCY AND THE SIGNIFICANCE OF DIVIDENDS PAID IN THE PAST?

ANSWER: No dividends had ever been paid by any of the corporations, but there were very sound business reasons why no such dividends had been paid.

Each of the corporations had been formed on April 10, 1946, and each of them was required by the terms of its Capital Standards Agreement with Chevrolet Motor Di-



vision to build up, prior to August 15, 1948, and to maintain thereafter, a Total Owned Capital of not less than \$300,533.00, with failure to do so constituting grounds for termination of its franchise. By December 31, 1946, none of the corporations had attained this required status, and each of them had its capital fully employed in its business operations.

By December 31, 1947, Capitol Chevrolet Co. had built up its Total Owned Capital to \$325,856.62 and could, therefore, have paid a dividend of some \$25,000.00 without violating its Capital Standards Agreement. However, on December 31, 1947, this corporation had cash on hand of only \$75,443.74 and current liabilities, including federal income taxes for the year, of \$273,479.75.

On December 31, 1947, Mid-Valley Chevrolet Co. had built up its Total Owned Capital to \$310,853.04 and could have paid a dividend of some \$10,000.00 without violation of its Capital Standards Agreement. However, this corporation's cash on hand on December 31, 1947, was only \$186,026.15, whereas its current liabilities, including federal income taxes for the year, amounted to \$234,129.35.

Comparing the cash balances of these two corporations with their cash requirements it seems clear that their failure to pay dividends in the year 1947 was dictated by prudent business judgment.

On December 31, 1947, Howell Chevrolet Co. had built up its Total Owned Capital to only \$287,643.74 and was still short of its contract requirement, hence its decision not to pay a dividend for that year can hardly be questioned.

The payment of dividends in the year 1948 was, of course, made impossible by the very distributions which

are here in question for the reason that such distributions reduced the corporations' working capital below the minimum required for their continued operations.

6. DOES THE CAPITALIZATION, AT THE TIME OF CANCELLATION OF THE STOCK, REPRESENT CAPITAL PAID IN, OR EARNINGS FROM THE BUSINESS?

ANSWER: Capital paid in.

7. WAS THERE A SUFFICIENT ACCUMULATION OF EARNED SURPLUS TO COVER THE DISTRIBUTION, OR WAS IT PARTLY FROM CAPITAL?

ANSWER: There was a sufficient accumulation of earned surplus in each corporation to cover the distribution in full, but each distribution was made partly from capital and partly from surplus.

8. WAS THERE A MAINTENANCE OF A RELATIVELY SIMILAR AMOUNT OF CAPITAL LIABILITY, OR DID THAT FIGURE DECREASE SOMEWHAT COMPARABLE TO THE PURPORTED DISTRIBUTION OF CAPITAL?

ANSWER: In the case of each corporation, capital liability decreased in substantially the same ratio as the capital distribution, to-wit:

	<u>Percentage of capital distributed</u>	<u>Percentage decrease in capital liability</u>
(a) Capitol Chevrolet Co.	30.5%	32.5%
(b) Mid-Valley Chevrolet Co.	30.5%	32.5%
(c) Howell Chevrolet Co.	32.9%	33.3%

9. WAS THERE GOOD FAITH, OR BAD, IN THE ACTION OF THE BOARD OF DIRECTORS?

ANSWER: In each case the Board of Directors acted in the utmost good faith and in reliance upon the recom-



mentation of competent counsel made after a long study in which the possible alternatives to the distributions in question were given full consideration and only rejected because impossible of accomplishment.

10. WHAT WAS THE NET EFFECT OF ACTIONS TAKEN?

ANSWER: To answer this question requires a definition of the term and that definition is found in the opinion of this Court in *Earle v. Woodlaw, supra*, where, immediately following the question, the Court states:

“If all purchases of its own stock by a corporation taken together accomplish the same result as the declaration of a dividend, a gain derived by a stockholder therefrom is taxable as a dividend.”

Under this definition, the answer to the question in the case at bar is clear and is simply this:

“The net effect of the actions taken was not equivalent to that of a taxable dividend because payment of an ordinary dividend in the same amount, or in any amount, would not have accomplished the same result.”

To establish the accuracy of this answer we must start with the result which was accomplished by the distributions which were actually made. This result had two distinct features, namely:

(a) The reduction of the number of shares owned by the Patricia May Kenyon Trust from 170 to 40 in Capitol Chevrolet Co., from 170 to 40 in Mid-Valley Chevrolet Co. and from 120 to 20 in Howell Chevrolet Co., and

(b) The maintenance of James A. Kenyon's percentage of control in both Capitol Chevrolet Co., and

Mid-Valley Chevrolet Co. at 50% and the maintenance of his percentage of control in Howell Chevrolet Co. at  $33\frac{1}{3}\%$  notwithstanding his loss of voting power resulting from the reduction of the Trust's ownership in the three corporations.

Obviously, no ordinary dividend could have accomplished both of the foregoing features because no ordinary dividend would have reduced the Trust's ownership in any of the corporations; and counsel for Appellants believe that this fact, standing alone, should be sufficient to meet the "net effect" test. However, since it may be argued that an ordinary dividend, coupled with some appropriate action on the part of the shareholders, could have achieved both of the required features, counsel believe it to be appropriate to show that *no dividend* coupled with any possible action on the part of any shareholder could have accomplished the same result as was accomplished by the distributions which were actually made.

One of the required features of the result accomplished by the distribution actually made was the reduction of the Trust's ownership of stock in the three corporations, and that feature could have been accomplished in only two ways:

(1) Redemption by the corporations of the Trust owned shares, or

(2) Sale by the Trust of its shares of stock in the corporations.

The other required feature of the result was that Mr. Kenyon's relative control in the three companies remain unchanged after the reduction of the Trust's stock ownership in the corporations, and, absent a retirement by the

corporations of a part of the stock owned by the other individual shareholders, that feature could have been accomplished only by having either J. A. K. Co., or Mr. Kenyon:

(a) Purchase from each of the corporations one share of stock for each Trust share redeemed; or

(b) Purchase from Mr. or Mrs. Phelps one-half share of Capitol Chevrolet Co. and Mid-Valley Chevrolet Co. stock for each share of Trust stock redeemed by those corporations and purchase from Mr. or Mrs. Phelps and from Jackson Howell one-third share of Howell Chevrolet Co. stock for each Trust share redeemed by that corporation; or

(c) Purchase the Trust owned shares directly from the Trust.

Combining the two methods by which the Trust's ownership in the corporations could be reduced with the three methods by which Mr. Kenyon's control in the corporations could have been maintained at its existing level we find that there were the following three alternatives, employing the use of ordinary dividends instead of the redemption of Appellants' and Jackson Howell's shares, which *seemingly* might have accomplished the necessary result, namely:

*Alternative 1.* Redemption of the Trust shares by the companies to the same extent as was actually done, followed by the purchase by J. A. K. Co. or James A. Kenyon of 130 shares directly from each Capitol Chevrolet Co. and Mid-Valley Chevrolet Co., and 100 shares from Howell Chevrolet Co., such purchase being followed in turn by the payment by the three corporations of ordinary

dividends in an amount sufficient to yield the purchaser the funds necessary to pay the purchase price.

*Alternative 2.* Redemption of the Trust shares by the companies to the same extent as was actually done, followed by the purchase by either J. A. K. Co. or James A. Kenyon personally of 65 shares of Capitol Chevrolet stock and 65 shares of Mid-Valley Chevrolet stock from Mr. or Mrs. Phelps, and the purchase of  $33\frac{1}{3}$  shares of Howell Chevrolet stock from Mr. or Mrs. Phelps, and a like number of such corporation's shares from Mr. Howell, such purchases being followed in turn by the payment of ordinary dividends by the three corporations in an amount sufficient to yield the purchaser the funds necessary to pay the purchase price.

*Alternative 3.* Sale of the Trust shares either to J. A. K. Co. or to James A. Kenyon, followed by the payment of ordinary dividends *by the three corporations* in an amount sufficient to enable the purchaser to pay the purchase price of such shares.

The question which must be answered, then, is this:

“If any one of the foregoing alternatives had been adopted would it in fact have accomplished the same result as that which was accomplished by what was done?”

With the answer to this question as our goal let us examine each of these alternatives in turn:

*Alternative 1:*

Since this alternative, on its face, would require the payment of ordinary dividends in twice the amount required by Alternative 2, we shall not pursue it further because, as it will be seen, Alternative 2 itself would not have accomplished the required result.

*Alternative 2:*

Under this alternative the three corporations would have redeemed the Trust shares in the same manner as was actually done and following such redemption either J. A. K. Co. or Mr. Kenyon would have purchased from Mr. or Mrs. Phelps the number of shares (65 in each corporation) required to maintain his 50% control in Capitol Chevrolet Co. and Mid-Valley Chevrolet Co. and either J. A. K. Co. or Mr. Kenyon would have purchased  $33\frac{1}{3}$  shares of Howell Chevrolet Co. stock from Mr. or Mrs. Phelps and a like number from Jackson Howell in order to maintain his  $33\frac{1}{3}\%$  control in that company.

Also, under this alternative, and for the purpose of applying the "net effect" test, the three corporations will be assumed to have paid, after the redemption of the Trust shares and after the purchases by J. A. K. Co. or Mr. Kenyon, ordinary dividends in amounts equal to the difference between the total amounts which were actually distributed and the amounts required to redeem only the Trust shares. Under this alternative, then, the critical point to be determined is whether or not the payment of such dividends would have enabled either J. A. K. Co. or Mr. Kenyon to have paid the purchase price of the shares purchased from Mr. or Mrs. Phelps and from Mr. Howell.

The detailed computations by which this determination is made are set out in full in the Appendix, pages 1 to 5 and the determination is this: If J. A. K. Co. had been the purchaser, the net amount available to it to apply in the purchase of the shares would have fallen short of the purchase price by \$91,920.25, and if James A. Kenyon had been the purchaser the net amount avail-



able to him to apply in the purchase of the shares would have fallen short of the purchase price by \$55,168.96.

It is clear, therefore, that this alternative would not have accomplished the same result as that which was accomplished by what was done since it would not have enabled Mr. Kenyon to maintain his control in the three corporations.

Furthermore, not only would ordinary dividends in an amount equal to the distributions which were actually made not have accomplished the same result, but also it is a fact, which is proven in the computations appearing on pages 6 to 10 of the Appendix, that if this alternative had been adopted and if each of the three corporations *had paid out their entire earned surpluses* as ordinary dividends the net amount available to either J. A. K. Co., if it had been the purchaser of the Phelps and Howell shares, or to James A. Kenyon, if he had been the purchaser of such shares, would not have been sufficient to pay the purchase price of such shares!

### *Alternative 3:*

Under this alternative the corporations would not have redeemed any shares and either J. A. K. Co. or Mr. Kenyon would simply have purchased directly from the Trust 130 Capitol Chevrolet Co. shares, 130 Mid-Valley Chevrolet Co. shares and 100 Howell Chevrolet Co. shares. Following this purchase, and for the purpose of applying the "net effect" test, the three corporations will be assumed to have paid, after such purchase, ordinary dividends in



an amount equal to the full distributions which were actually made.

Under this alternative the critical point to be determined is similar to the point for determination under Alternative 2, *i.e.*, “Would the payment of such dividends have enabled either J. A. K. Co. or Mr. Kenyon to have paid the purchase price of the shares purchased from the Trust?”

The detailed computations by which such determination is made are set out in full in the Appendix, pages 11 to 15 and the determination is this: If J. A. K. Co. had been the purchaser of the shares the net amount available to it to apply in the purchase of the shares would have fallen short of the purchase price by \$170,304.02; and if Mr. Kenyon, personally, had been the purchaser the net amount available to him to apply in the purchase of the shares would have fallen short of the purchase price by \$135,804.58.

It is clear, therefore, that this alternative would also have failed to accomplish the same result as that which was accomplished by what was done since it, too, would not have enabled Mr. Kenyon to maintain his control in the three corporations.

As in the case of Alternative 2, it can be demonstrated that (under this alternative) not only would ordinary dividends in an amount equal to the distributions which were actually made not have accomplished the same result as that which was actually accomplished, but also that even if the three corporations had paid out their *entire* earned

surpluses as ordinary dividends the net amount available to either J. A. K. Co., if it had been the purchaser of the Trust shares, or to Mr. Kenyon if he had been the purchaser of such shares, would have fallen far short of the amount required for the payment of the purchase price of such shares. The detailed computations demonstrating this fact are set forth in the Appendix, pages 15 to 20.

### Conclusion—Point II.

From the foregoing it has been seen that the distributions here in question pass all of the tests required for exclusion from the operation of Section 115(g) other than numbers 1, 2, 5 and 7. Therefore, even if these tests were to be given equal weight the scales are tipped in favor of Appellants. Moreover, since this Court has held in the *Earle* case, *supra*, that the tests are not to be given equal weight, and that it is the “net effect” test which is of the most importance, and since there are included among the tests which have been passed both that of legitimate business purpose (which was held to be of great importance in *Commissioner v. Sullivan*, 210 F. 2d 607) and that of non-pro rata distribution (which is uniformly held by the Courts to be a strong factor in the determination) it is respectfully submitted that the scales are tipped, not slightly, but predominately, in Appellants’ favor and that The Tax Court clearly erred in failing to hold that the distributions to Appellants were not essentially equivalent to taxable dividends.

### POINT III.

The Distributions to Appellants in Redemption of a Part of Their Shares in Each of the Three Corporations Constituted Amounts Distributed in Partial Liquidation of the Corporations and Were Properly Reported as Such by Appellants on Their Return for the Year 1948.

Sections 115(c) and 115(i) of the Internal Revenue Code of 1939 provide as follows:

“(c) (as amended by Sec. 147 of the Revenue Act of 1942 *supra*) Distributions in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

\* \* \*

“(i) Definition of Partial Liquidation.—As used in this section the term ‘amounts distributed in partial liquidation’ means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.”

The redemptions of Appellants' 65 shares, each, of stock in Capitol Chevrolet Co. and Mid-Valley Chevrolet Co. and the redemption of their 50 shares, each, of stock in Howell Chevrolet Co. constituted partial liquidations of those corporations and the amounts distributed to Appellants constituted amounts distributed in partial liquidation within the meaning of Section 115(i) of the Internal Revenue Code of 1939. Under Section 115(c) of the Code such amounts were required to be treated as payment in exchange for the shares redeemed, hence Appellants' action in so treating them on their return for the year 1948 was proper and The Tax Court erred in failing so to find.

### Conclusion.

The decision of The Tax Court of the United States is clearly erroneous and should be reversed.

Respectfully submitted,

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## APPENDIX.

### Computation of Amount Available to J.A.K. Co. as Purchaser or James A. Kenyon as Purchaser for Payment of Purchase Price of Phelps and Howell Shares Under Alternative 2.

(A) Amounts to be distributed as ordinary dividends:

	<u>Capitol</u>	<u>Mid-Valley</u>	<u>Howell</u>
Total Distribution	\$151,036.60	148,681.00	139,524.00
Distributed to Trust	<u>75,518.30</u>	<u>74,340.50</u>	<u>46,508.00</u>
Available for Distribution as Ordinary Dividend	\$ 75,518.30	74,340.50	93,016.00

(B) Purchase price of shares to be purchased:

65 Shares Capitol	\$ 37,759.15
65 Shares Mid-Valley	37,170.25
66 $\frac{2}{3}$ Shares Howell	<u>31,005.33</u>
Total	\$105,934.73

### CASE I—ASSUME J.A.K. CO. AS PURCHASER

If J.A.K. Co. were to have been the purchaser of the shares from Mr. or Mrs. Phelps and Jackson Howell, then upon distribution of the ordinary dividend after redemption of the trust shares it would have received the following dividends from the three companies:

*Capitol:*

$$\frac{320}{720} \times 75,518.30 = 33,563.69$$

*Mid-Valley:*

$$\frac{320}{720} \times 74,340.50 = 33,040.22$$

*Howell:*

$$\frac{246\frac{2}{3}}{800} \times 93,016 = 28,679.93$$

Total Dividends Received	\$95,283.84
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Assuming J.A.K. Co. to have had no other income its tax on these dividends would have been:

*Federal Normal and Surtax*

Net Income	\$95,283.84
Less: Dividends received credit	80,991.26 (a)
	<hr/>
Total subject to normal and surtax	<u>\$14,292.58</u>
Tax: On first \$5,000	\$1,050.00
On next \$9,293.43	2,137.29
	<hr/>
Total normal and surtax	\$3,187.29 (b)

*Federal Personal Holding Company Surtax*

Net Income	\$95,283.84
Less: Normal and surtax	3,187.29
	<hr/>

Undistributed Net Income subject to	
Personal Holding Company Surtax	<u>\$92,096.55 (c)</u>
Tax: On first \$2,000	\$ 1,500.00
On \$90,096.55	76,582.07
	<hr/>
Total Personal Holding Company Surtax	\$78,082.07 (d)

*Recap:*

Normal and Surtax	\$ 3,187.29
Personal Holding Company Surtax	78,082.07
	<hr/>
Total Tax	\$81,269.36

The maximum amount available to J.A.K. Co. to apply to the purchase price of the Phelps and Howell shares would have been the excess of the dividends received by it from the three companies over the total taxes payable on such dividends:

Total dividends	\$ 95,283.84
Total taxes payable	81,269.36
	<hr/>
Available to apply to purchase	\$ 14,014.48

CONCLUSION:

Purchase Price	\$105,934.73
Available to J.A.K. Co.	14,014.48
	<hr/>
Shortage	\$ 91,920.25

## CASE II—ASSUME JAMES A. KENYON AS PURCHASER

If Mr. Kenyon were to have been the purchaser of the shares from Mr. or Mrs. Phelps and Jackson Howell, then upon distribution of the ordinary dividend after redemption of Trust shares he and J.A.K. Co. would have received the following dividends from the three companies:

*Capitol:* *J.A.K. Co. James A. Kenyon*

$$\text{J.A.K. Co.: } \frac{255}{720} \times 75,518.30 = 26,746.06$$

$$\text{Kenyon: } \frac{65}{720} \times 75,518.30 = 6,817.62$$

*Mid-Valley:*

$$\text{J.A.K. Co.: } \frac{255}{720} \times 74,340.50 = 26,328.93$$

$$\text{Kenyon: } \frac{65}{720} \times 74,340.50 = 6,711.30$$

*Howell:*

$$\text{J.A.K. Co.: } \frac{180}{800} \times 93,016.00 = 20,928.60$$

$$\text{Kenyon: } \frac{66\frac{2}{3}}{800} \times 93,016.00 = 7,751.33$$

TOTAL J.A.K. Co. \$74,003.59

TOTAL JAMES A. KENYON \$21,280.25

Assuming J.A.K. Co. to have had no other income, its tax on these dividends would have been:

*Federal Normal and Surtax:*

Net Income	\$74,003.59
Less: Dividends received credit	62,903.05 (a)

Total subject to normal and surtax	<u>\$11,100.54</u>
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Tax: On first \$5,000	\$1,050.00
On next \$6,100.54	1,403.12

Total normal and surtax	<u>\$2,453.12 (b)</u>
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J.A.K. Co. would, therefore, have been able to pay to Mr. Kenyon a dividend in an amount equal to the difference between the total dividends received by it from the three corporations and the taxes payable upon such dividends:

Total dividends received	\$74,003.59
Taxes payable thereon	2,453.12
Available for distribution to Mr. Kenyon	<u>\$71,550.47</u>

The dividends received by Mr. Kenyon from the three corporations and from J.A.K. Co. would have been taxable income to him and would have been in addition to his other income for the year, making him subject to Federal and California income taxes as follows:

*Federal Tax*

Net income from all sources other than dividends from the three corporations and J.A.K. Co. [R. 193]	\$106,429.40
Dividends from the three corporations	21,280.25
Dividends from J.A.K. Co.	71,550.47
Total taxable net income	<u>\$199,260.12</u>
Personal exemption and credit for dependents	1,200.00 (e)
Subject to tax	<u><u>\$198,060.12</u></u>
Tentative Normal and Surtax:	
On \$150,000	\$111,820.00
On \$48,060.12 at 90%	43,254.11
Total tentative tax	<u>\$155,074.11 (f)</u>
1948 Reduction:	
On \$100,000	12,020.00
On \$55,074.11 at 9.75%	5,369.73
	<u>17,389.73 (g)</u>
Total Normal and Surtax after Reduction	\$137,684.38
Limited to 77% of \$199,260.12	153,430.29 (h)
Total Federal tax payable	<u>\$137,684.38</u>
* * * * *	* * *

*California Tax:*

Total net income per Federal	\$199,260.12
Add: 1947 California income taxes not deductible	972.77 (i)
California net taxable income	<u>\$200,232.89</u>
Personal exemption and credit for dependents	3,400.00 (j)
Subject to tax	<u><u>\$196,832.89</u></u>

Tax:

On first \$30,000	800.00
On \$166,832.89 at 6%	10,009.97 (k)

Total California Tax	<u>\$10,809.97</u>
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RECAP:

Federal tax payable	\$137,684.38
California tax payable	10,809.97
Total	<u>\$148,494.35</u>

The maximum amount available to Mr. Kenyon to apply to the purchase price of the Phelps and Howell shares would be the excess of his total net income for the year, including the dividends from the three corporations and J.A.K. Co., over his total taxes payable for the year:

Total net income	\$199,260.12
Total taxes payable	148,494.35
Available to apply to purchase	<u>\$ 50,765.77</u>

CONCLUSION

Total purchase price of Phelps and Howell shares	\$105,934.73
Amount available to apply to purchase price	<u>50,765.77</u>
Shortage	<u>\$ 55,168.96</u>

Proof of the Fact That It Would Have Been Impossible for the Three Corporations to Have Paid Ordinary Dividends in an Amount Sufficient to Enable James A. Kenyon to Pay the Purchase Price of 65 Shares of Capitol Chevrolet Co. Stock, 65 Shares of Mid-Valley Chevrolet Co. Stock and 66-2/3 Shares of the Howell Chevrolet Stock if He Had Purchased Such Shares From Mr. or Mrs. Phelps and Jackson Howell After the Trust Shares Had Been Redeemed.

*Factors:*

(1) The purchase price to be paid for the purchased shares would have been the same as the redemption price, *i.e.*

65 sh. Capitol Chevrolet Co.	\$ 37,759.15
65 sh. Mid-Valley Chevrolet Co.	37,170.25
66-2/3 sh. Howell Chevrolet Co.	31,005.33
	<hr/>
	\$105,934.73

(2) The corporate earned surpluses which would have been available for payment of ordinary dividends after the redemption of the Trust shares would have been:

*Capitol Chevrolet Co.*

Actual surplus at 12-31-48		
[Jt. Ex. 21-V; Appx. p. 57]		\$285,666.90
Amount distributed in redemption of Phelps shares	\$75,518.30	
Portion of Phelps redemption charged to capital	13,000.00	
	<hr/>	
Portion of Phelps redemption charged to surplus	\$62,518.30	62,518.30
		<hr/>
Earned surplus which would have been on hand if Phelps redemption had not been made		\$348,185.20



*Mid-Valley Chevrolet Co.*

Actual surplus at 12-31-48 [Jt. Ex. 16-P; Appx. 54]		\$275,536.12
Amount distributed in redemption of Phelps shares	\$74,340.50	
Portion of Phelps redemption charged to capital	<u>13,000.00</u>	
Portion of Phelps redemption charged to surplus	61,340.50	<u>61,340.50</u>
Earned surplus which would have been on hand if Phelps redemption had not been made		\$336,876.62

*Howell Chevrolet Co.*

Actual surplus at 12-31-48 [Jt. Ex. 11-K; Appx. 51]		\$223,970.73
Amount distributed in redemption of Phelps and Howell shares	\$93,016.00	
Portion of Phelps and Howell redemptions charged to capital	<u>20,000.00</u>	
Portion of Phelps and Howell redemption charged to surplus	73,016.00	<u>73,016.00</u>
Earned surplus which would have been on hand if Phelps and Howell re- demptions had not been made		\$296,986.73

(3) If James A. Kenyon had purchased 65 shares of Capitol Chevrolet Co. and 65 shares of Mid-Valley Chevrolet Co. from Mr. or Mrs. Phelps and had purchased  $33\frac{1}{3}$  shares of Howell Chevrolet Co. from Mr. or Mrs. Phelps and a like number of Howell shares from Jackson Howell after the Trust shares had been redeemed, and if following such purchases the corporations had paid out, as ordinary dividends, their *entire* earned surpluses which would then have been on hand, J.A.K. Co. and James A. Kenyon would have received the following dividends:

Capitol Chevrolet Co.:

J.A.K. Co. James A. Kenyon

$$\text{J.A.K. Co.: } \frac{255}{720} \times 348,185.20 = 123,315.59$$

$$\text{Kenyon: } \frac{65}{720} \times 348,185.20 = 31,433.39$$

Mid-Valley Chevrolet Co.

$$\text{J.A.K. Co.: } \frac{255}{720} \times 336,876.62 = 119,310.47$$

$$\text{Kenyon: } \frac{65}{720} \times 336,876.62 = 30,412.47$$

Howell Chevrolet Co.

$$\text{J.A.K. Co.: } \frac{180}{800} \times 296,986.73 = 66,822.01$$

$$\text{Kenyon: } \frac{66\frac{2}{3}}{800} \times 296,986.73 = 24,748.89$$

TOTAL J.A.K. Co.	<u>\$309,448.07</u>	
TOTAL James A. Kenyon		<u>\$86,594.75</u>

(4) If J.A.K. Co. had no income other than the dividends which it would have received from the three corporations it would have been able to pay a dividend to James A. Kenyon equal to the entire amount of such dividends so received by it less the amount of Federal income tax due on the amount so received:

Net Income	\$309,448.07
Less: Dividends received credit	<u>263,030.86 (a)</u>
Total taxable	\$ 46,417.21
Tax: On first \$5000 —	\$ 1050.00
“ next 15,000 —	3,450.00
“ next 5,000 —	1,250.00
“ next 21,417.21 —	<u>11,351.12</u>
Total Tax	\$17,101.12 (b)
Total dividends received —	\$309,448.07
Federal tax thereon —	<u>17,101.12</u>
Available for distribution to James A. Kenyon	\$292,346.95

(5) The dividends received by James A. Kenyon from the three corporations and from J.A.K. Co. would have been taxable income to him and would have been in addition to the other income for the year, making him subject to Federal and California income taxes as follows:

*Federal tax:*

Net income from all such other than dividends from the three corporations and J.A.K. Co. (R. 193)	\$106,429.40
Dividends from the three corporations	86,594.75
Dividends from J.A.K. Co.	292,346.95
	<hr/>
Total taxable net income	\$485,371.10
Personal exemption and credit for dependents	1,200.00 (e)
	<hr/>
Subject to tax	\$484,171.10

*Tentative Normal Tax and Surtax:*

On \$200,000	\$156,820.00
On 284,171.10 @ 91%	258,595.70
	<hr/>
Total Tentative Tax	\$415,415.70 (f)

*1948 Reduction:*

On \$100,000	\$ 12,020.00	
On \$315,415.70 @ 9.75%	30,753.03	42,773.03 (g)
	<hr/>	<hr/>
Total normal and surtax after reduction		\$372,642.67
Limited to 77% of \$485,371.10		\$373,735.75 (h)
Total Federal tax payable		\$372,642.67

*California Tax:*

Total net income per Federal	\$485,371.10
Add: 1947 California income taxes not deductible	972.77 (i)
	<hr/>
California net taxable income	486,343.87
Personal exemption and credit for dependents	3,400.00 (j)
	<hr/>
Subject to tax	482,943.87
	<hr/>
Tax on first \$30,000 =	800.00
Tax on \$452,943.87 @ 6% =	27,176.63
Total California tax	\$27,976.63 (k)

RECAP:

Federal tax payable	\$372,642.67
California tax payable	27,976.63
Total taxes payable for year	<u>\$400,619.30</u>

(6) The maximum amount available to James A. Kenyon for use in paying the purchase price of the shares purchased from Mr. and/or Mrs. Phelps and Jackson Howell would be his net taxable income received from all sources during the year less the Federal and California income taxes payable for such year:

Total net income from all sources	\$485,371.10
Total Federal and California income taxes payable	<u>400,619.30</u>
Total amount available for payment of purchase price of shares purchased from Mr. and/or Mrs. Phelps and Jackson Howell	\$ 84,751.80

CONCLUSION

Since the purchase price of the shares purchased from Mr. and Mrs. Phelps and Jackson Howell would have been \$105,934.73 and since the total amount, including his entire income from all sources, which James A. Kenyon would have been able to apply to such purchase if the three corporations had paid out every penny of their earned surpluses as ordinary dividends would have been only \$84,751.80, it follows that it would have been *impossible* for the three corporations to have paid ordinary dividends in an amount sufficient to enable Mr. Kenyon to pay the purchase price of such shares.

(Notes (a) through (k): See Appx. p. 21 for statutory authority for factors used.)

Computation of Amount Available to J.A.K. Co. as Purchaser, or James A. Kenyon as Purchaser, for Payment of Purchase Price of Trust Shares Under Alternative 3.

(A) Amounts to be distributed as ordinary dividends:

<i>Capitol</i>	<i>Mid-Valley</i>	<i>Howell</i>
\$151,036.60	\$148,681.00	\$139,524.00

(B) Purchase price of shares to be purchased:

130 sh. Capitol	75,518.30
130 sh. Mid-Valley	74,340.50
100 sh. Howell	46,508.00

Total	<hr/> 196,366.80
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CASE I: ASSUME J.A.K. CO. AS PURCHASER.

If J.A.K. Co. were to have been the purchaser of the shares from the Trust, then upon distribution of the ordinary dividend it would have received the following amounts from the three companies:

*Capitol:*

$$\frac{385}{850} \times \$151,036.61 = \$68,410.70$$

*Mid-Valley:*

$$\frac{385}{850} \times 148,681.00 = 67,343.75$$

*Howell:*

$$\frac{280}{900} \times 139,524.00 = 43,407.47$$

Total	<hr/> \$179,161.92
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Assuming J.A.K. Co. to have had no other income, its tax on these dividends would have been:

*Federal Normal and Surtax:*

Net income	\$179,161.92
Less: Dividends received credit	152,287.63 (a)
	<hr/>
Total subject to normal and surtax	\$ 26,874.29
Tax: On first \$5,000 —	\$1,050.00
" next 15,000 —	3,450.00
" next 5,000 —	1,250.00
" next 1,874.29	993.37
	<hr/>
Total normal and surtax	\$6,743.37 (b)

*Federal Personal Holding Company Surtax:*

Net income	\$179,161.92
Less: Normal and surtax	6,743.37
	<hr/>
Undistributed net income subject to personal holding company surtax	\$172,418.55 (c)
Tax on first \$2,000	\$ 1,500.00
Tax on 170,418.55	144,855.77
	<hr/>
Total personal holding company surtax	\$146,355.77 (d)

RECAP:

Normal and surtax	\$ 6,743.37
Personal holding company surtax	146,355.77
	<hr/>
	\$153,099.14

The maximum amount available to J.A.K. Co. to apply to the purchase price of the trust shares would be the excess of the total dividends received by it from the three companies over the total taxes payable on such dividends:

Total dividends	\$179,161.92
Total taxes payable	153,099.14
	<hr/>
Available to apply to purchase	\$26,062.78

CONCLUSION:

Total purchase price of trust shares	\$196,366.80
Amount available to apply to purchase price	26,062.78
	<hr/>
Shortage	\$170,304.02



## CASE II: ASSUME JAMES A. KENYON AS PURCHASER

If Mr. Kenyon had been the purchaser of the shares from the Trust, then upon distribution of the ordinary dividend he and J.A.K. Co. would have received the following dividends from the three companies:

<u>Capitol:</u>		<u>J.A.K. Co.</u>	<u>James A. Kenyon</u>
J.A.K. Co.	$\frac{255}{850} \times 151,036.61 =$	45,310.98	
Kenyon	$\frac{130}{850} \times 151,036.61 =$		23,099.72
<i>Mid-Valley:</i>			
J.A.K. Co.	$\frac{255}{850} \times 148,681.00 =$	44,604.30	
Kenyon	$\frac{130}{850} \times 148,681.00 =$		22,739.45
<i>Howell:</i>			
J.A.K. Co.	$\frac{180}{900} \times 139,524.00 =$	27,904.80	
Kenyon	$\frac{100}{900} \times 139,524.00 =$		15,502.67
Total J.A.K. Co.		<hr/> \$117,820.08	
Total Kenyon			<hr/> \$61,341.84

Assuming J.A.K. Co. to have had no other income, its tax on these dividends would have been:

### *Federal Normal and Surtax:*

Net income	\$117,820.08
Less: Dividends received credit	100,147.07 (a)
Total subject to normal and surtax	<hr/> \$17,673.01
Tax: On first 5,000 —	\$1,050.00
" next 12,673.01	2,914.79
Total normal and surtax	<hr/> \$3,964.79 (b)

J.A.K. Co. would, therefore, have been able to pay to Mr. Kenyon a dividend in an amount equal to the difference between the total dividends received by it from the three corporations and the taxes payable upon such dividends:

Total dividends received	\$117,820.08
Taxes payable thereon	3,964.79
	<hr/>
Available for distribution to Mr. Kenyon	\$113,855.29

The dividends received by Mr. Kenyon from the three corporations and from J.A.K. Co. would have been taxable income to him and would have been in addition to his other income for the year, making him subject to Federal and California income taxes as follows:

*Federal Tax:*

Net income from all sources other than dividends from the three corporations and J.A.K. Co. (R. 193)	\$106,429.40
Dividends from the three corporations	61,341.84
Dividends from J.A.K. Co.	113,855.29
	<hr/>
Total taxable net income	\$281,626.53
Personal exemption and credit for dependents	1,200.00 (e)
	<hr/>
Subject to tax	\$280,426.53

*Tentative Normal and Surtax:*

On \$200,000	\$156,820.00
On \$80,426.53 @ 91%	73,188.14
Total tentative tax	\$230,008.14 (f)

*1948 Reduction:*

On \$100,000	\$12,020.00	
On 130,008.14 @ 9.75%	12,675.79	24,695.79 (g)
	<hr/>	<hr/>
Total normal and surtax after reduction		\$205,312.35
Limited to 77% of \$281,626.53		216,852.43 (h)
Total Federal tax payable		205,312.35

*California Tax:*

Total net income per Federal	\$281,626.53
Add: 1947 California income tax not deductible	972.77 (i)
	<hr/>
California net taxable income	\$282,599.30
Personal exemption and credit for dependents	3,400.00 (j)
	<hr/>
Subject to tax	\$279,199.30
Tax on first \$30,000.00	\$ 800.00
Tax on 249,199.30 @ 6%	14,951.96
	<hr/>
	\$15,751.96 (k)

RECAP:

Federal tax payable	\$205,312.35
California tax payable	15,751.96
	<hr/>
Total	\$221,064.31

The maximum amount available to Mr. Kenyon to apply to the purchase price of the trust shares would be the excess of his total net income for the year, including the dividends from the three corporations and J.A.K. Co., over his total taxes payable for the year:

Total net income	\$281,626.53
Total taxes payable	221,064.31
	<hr/>
Available to apply to purchase	\$ 60,562.22

CONCLUSION:

Total purchase price of trust shares	\$196,366.80
Amount available to apply to purchase price	60,562.22
	<hr/>
Shortage	\$135,804.58

(Notes (a) through (k): See Appx. p. 21 for statutory authority for factors used.)

**Proof of the Fact That It Would Have Been Impossible for the Three Corporations to Have Paid Ordinary Dividends in an Amount Sufficient to Enable James A. Kenyon to Pay the Purchase Price of 130 Shares of Capitol Chevrolet Co. Stock, 130 Shares of Mid-Valley Chevrolet Co. Stock and 100 Shares of Howell Chevrolet Co. Stock if He Had Purchased Said Shares Directly From the Trust.**

*Factors:*

(1) The purchase price to be paid for the trust shares would have been the same as the redemption price: *i. e.*,

130 sh. Capitol Chevrolet Co. —	\$ 75,518.30
130 " Mid-Valley Chevrolet Co. —	74,340.50
100 " Howell Chevrolet Co. —	46,508.00
	<hr/>
	\$196,366.80 (R. 19, 20)

(2) The corporate earned surpluses which would have been available for payment of ordinary dividends if the redemptions had not been made would have been:

*Capitol Chevrolet Co.*

Actual surplus at 12-31-48	
[Ex. 21-V, Appx. p. 57]	\$285,666.90
Total amount distributed in redemption	\$151,036.60 [R. 19]
Portion of redemption distribution charged to capital	26,000.00
	<hr/>
Portion of redemption distribution charged to surplus	125,036.60
[Ex. 21-V, Sched. L; Appx. p. 57]	125,036.60
	<hr/>
Earned surplus which would have been on hand if redemption had not been made	\$410,703.50

*Mid-Valley Chevrolet Co.:*

Actual surplus at 12-31-48		
[Ex. 16-P, Appx. p. 54]		\$275,536.12
Total amount distributed in redemption	\$148,681.00 [R. 20]	
Portion of redemption distribution charged to capital	26,000.00	
	<hr/>	
Portion of redemption distribution charged to surplus	122,681.00	
[Ex. 16-P, Sched. L; Appx. p. 54]		122,681.00
		<hr/>
Earned surplus which would have been on hand if redemption had not been made		\$398,217.12

*Howell Chevrolet Co.*

Actual surplus at 12-31-48		
[Ex. 11-K, Appx. p. 51]		\$223,970.73
Total amount distributed in redemption	\$139,524.00 [R. 20]	
Portion of redemption distribution charged to capital	30,000.00	
	<hr/>	
Portion of redemption distribution charged to surplus	109,524.00	109,524.00
[Ex. 11-K, Sched. L; Appx. p. 51]		<hr/>
Earned surplus which would have been on hand if redemption had not been made		\$333,494.73

(3) If James A. Kenyon, personally, had purchased 130 shares of Capitol Chevrolet Co., 130 shares of Mid-Valley Chevrolet Co. and 100 shares of Howell Chevrolet Co. from the Trust, and if following such purchase the corporations had paid out, as ordinary dividends, their *entire* earned surpluses which would then have been on hand, J.A.K. Co. and James A. Kenyon would have received the following dividends:

<u>Capital Chevrolet Co.</u>	<u>J.A.K. Co.</u>	<u>James A. Kenyon</u>
J.A.K. Co.: $\frac{255}{850} \times 410,703.50 =$	123,211.05	
Kenyon: $\frac{130}{850} \times 410,703.50 =$		62,813.48
<i>Mid-Valley Chevrolet Co.</i>		
J.A.K. Co.: $\frac{255}{850} \times 398,217.12 =$	119,465.14	
Kenyon: $\frac{130}{850} \times 398,217.12 =$		60,903.79
<i>Howell Chevrolet Co.</i>		
J.A.K. Co.: $\frac{180}{900} \times 333,494.73 =$	66,698.95	
Kenyon: $\frac{100}{900} \times 333,494.73 =$		37,054.97
Total Received by J.A.K. Co.	<u>\$309,375.14</u>	
Total Received by James A. Kenyon		<u>\$160,772.24</u>

(4) If J.A.K. Co. had no income other than the dividends which it would have received from the three corporations it would have been able to pay a dividend to James A. Kenyon equal to the entire amount of such dividends so received by it less the Federal income tax due on the amount so received:

Net Income	\$309,375.14
Less: Dividend received credit	262,968.87 (a)
Total taxable	<u>46,406.27</u>
Tax: On First \$5,000	1,050.00
On Next 15,000	3,450.00
On Next 5,000	1,250.00
On Next 21,406.27	<u>11,345.32</u>
TOTAL TAX	<u>\$17,095.32 (b)</u>
Total Dividends received	309,375.14
Federal tax thereon	<u>17,095.32</u>
Available for distribution to James A. Kenyon	<u>\$292,279.82</u>



(5) The dividends received by James A. Kenyon from the three corporations and from J.A.K. Co. would have been taxable income to him and would have been in addition to his other income for the year, making him subject to Federal and California income taxes as follows:

*Federal Tax*

Net income from all sources other than dividends from the three corporations and J.A.K. Co. [R. 193]	\$106,429.40
Dividends from the three corporations	160,772.24
Dividend from J.A.K. Co.	292,279.82
<b>Total Net Taxable income</b>	<b>559,481.46</b>
Personal Exemption and Credit for dependents	1,200.00 (e)
<b>Subject to tax:</b>	<b>558,281.46</b>
Tentative Normal Tax and Surtax:	
On \$200,000	156,820.00
On \$358,281.46 at 91%	326,036.13
<b>Total Tentative tax</b>	<b>\$482,856.13 (f)</b>
1948 Reduction:	
On \$100,000	12,020.00
On \$382,856.13 @ 9.75%	37,328.47
	49,348.47 (g)
<b>Total Normal and Surtax after reduction</b>	<b>\$433,507.66</b>
Limited to 77% of \$559,481.46 =	430,800.72
<b>Total Federal tax payable =</b>	<b>\$430,800.72</b>

*California Tax*

Total net taxable income per Federal	559,481.46
Add: 1947 California income tax is not deductible	972.77 (i)
<b>California Net Taxable Income</b>	<b>560,454.23</b>
Personal exemption and credit for dependents	3,400.00 (j)
<b>Subject to Tax</b>	<b>557,054.23</b>
Tax on first \$30,000.00	\$ 800.00
Tax on \$527,054.23 @ 6%	31,623.25 (k)
<b>Total California Tax</b>	<b>32,423.25</b>
Recap:	
Federal tax payable	\$430,800.72
California tax payable	32,423.25
<b>Total taxes payable for year</b>	<b>\$463,223.97</b>

(6) The maximum amount available to James A. Kenyon for use in paying the purchase price of the shares purchased from the Trust would be his net taxable income received from all sources during the year less the Federal and California income taxes payable for such year:

Total net income from all sources	\$559,481.46
Total Federal and California income taxes payable	463,223.97
	<hr/>
Maximum available for payment of purchase price of Trust shares	\$ 96,257.49

### Conclusion.

Since the purchase price of the Trust shares would have been \$196,366.80 and since the total amount, including his *entire* income from all sources, which James A. Kenyon would have been able to apply to such purchase if the three corporations had paid out every penny of their earned surpluses as ordinary dividends would have been only \$96,257.49, it follows that it would have been *impossible* for the three corporations to have paid ordinary dividends in an amount sufficient for James A. Kenyon to pay the purchase price of such shares.

(Notes (a) through (k)—See Appx. p. 21 for statutory authority for factors used.)

## Statutory Authority for Factors Used in Computations.

<u>Note</u>	<u>Factor in Computation</u>	<u>Applicable Statute</u>
(a)	Dividends Received Credit	IRC 1939, Sec. 26(b)
(b)	Normal and Surtax Rates (Corporation)	IRC 1939, Sec. 12(b) as amended by Sec. 104 of the Revenue Act of 1948
(c)	Undistributed Net Income	IRC 1939, Secs. 504, 505
(d)	Personal Holding Company Surtax Rates	IRC 1939, Sec. 500 as amended by Sec. 181 of the Revenue Act of 1942
(e)	Personal exemption and credit for dependents (Federal)	IRC 1939, Sec. 25(b) as amended by Sec. 201 of the Revenue Act of 1948
(f)	Tentative Normal and Surtax Rates (Individual)	IRC 1939, Sec. 12(a) and (b) as amended by Sec. 104 of the Rev- enue Act of 1948.
(g)	1948 Reduction	IRC 1939, Sec. (c)(1) as amend- ed by Sec. 104 of the Internal Revenue Code of 1948
(h)	Limitation on Tax	IRC 1939, Sec. (c)(2) as amend- ed by Sec. 104 of the Revenue Act of 1948
(i)	California income tax not deductible	Revenue and Taxation Code of the State of California, Sec. 17305
(j)	Personal exemption and credit for dependents (California)	Revenue and Taxation Code of the State of California, Sec. 17951 and Sec. 19201.5 as amend- ed by Chap. 12, Laws 1948
(k)	Tax Rates (California)	Revenue and Taxation Code of the State of California, Sec. 19200 as amended by Chap. 12, Laws 1948

## Joint Exhibit 4-D.

### DECLARATION OF TRUST

James A. Kenyon, hereinafter called "Trustee", hereby declares that he, with the written consent of his wife, Matilda R. Kenyon, has made a gift to his adopted daughter, Patricia May Kenyon, in trust, upon the terms and conditions hereinafter stated, and that he as "Trustor" has transferred and delivered to himself as "Trustee", without consideration other than the said gift, all right, title and interest in and to the properties described as: Two Hundred (200) shares of the Common Capital Stock of Mid-Valley Chevrolet Co., a California corporation, Valued at Twenty-five Thousand (\$25,000.00) Dollars.

All property now, or hereafter subject to this trust shall constitute the Trust Estate and shall be held, managed and distributed as hereinafter provided.

### ARTICLE I.

DISTRIBUTION OF INCOME AND PRINCIPAL	(1) The net income shall be distributed in annual or other convenient installments, as may be determined by the Trustee to or for the benefit of the said Patricia May Kenyon, hereinafter called the "Beneficiary" until she shall have reached the age of twenty-five (25) years. Her fourteenth birthday will be September 19, 1941.
--	---

During her minority, the said net income shall be paid to her guardian and no part thereof shall be used for her maintenance or support so long as she is a minor, excepting only by order of a Court of Probate or general jurisdiction, having jurisdiction of her guardian. After she shall have reached her ma-

jority, the said net income shall be paid directly to the said Beneficiary.

(2) When the said Beneficiary shall have reached the age of twenty-five (25) years, one-half ( $\frac{1}{2}$ ) of the corpus of the Trust Estate, together with all accumulated income, if any, shall be distributed to the said Beneficiary. The remaining one-half ( $\frac{1}{2}$ ) shall be held by the Trustee subject to the terms of this Trust and the net income therefrom shall be paid to the said Beneficiary in annual, or other convenient, installments until she shall have reached the age of thirty-five (35) years, at which time the remaining corpus of the estate together with all undistributed net income shall be distributed to the said Beneficiary.

(3)—(a) If the Beneficiary should die before becoming entitled to receive distribution of the entire Trust Estate, and if she shall have lawful children, then the net income from the undistributed remainder of the Trust Estate shall be distributed in annual, or other convenient, installments, to or be used for the benefit of the lawful child of the Beneficiary, if there be only one child and if more than one to them in equal shares, and if any of such children shall then be dead but shall leave issue, then his or her share shall go to such issue, and if there be more than one such issue, to them in equal shares; if any such child of the Beneficiary shall be dead at the time of the death of the Beneficiary and shall not leave issue, then his or her share shall go to augment the shares of the living children and the issue of any deceased child on the principle of representation, until such child of the Beneficiary (if there be only one, or until the youngest of such children if there be more than one) has reached the age of twenty-one (21)

years, or until twenty-five (25) years after the date of this Trust, which ever occurs first; whereupon the undistributed corpus and accumulated income, if any, shall be distributed to such living children in equal shares and to the issue of any deceased child by right of representation; and thereupon this Trust shall cease and determine.

(b) If the said Beneficiary shall die without leaving lawful children or the issue of any deceased child or children, then the undistributed corpus, together with all accumulated and undistributed income, if any, shall be distributed as follows: One-half ( $\frac{1}{2}$ ) thereof to Mary Haydee Zelaya, grand-daughter of the wife of the Trustor, one-fourth ( $\frac{1}{4}$ ) to Nan Perry and one-fourth ( $\frac{1}{4}$ ) thereof to Gail Perry, the latter two being nieces of the Trustor. If the said Mary Haydee Zelaya shall not be living at the time she would be entitled to such distribution, then her share shall be divided equally between the said Nan Perry and the said Gail Perry. If either the said Nan Perry and the said Gail Perry shall not then be living, then her share shall be divided three-fourths ( $\frac{3}{4}$ ) to the said Mary Haydee Zelaya and one-fourth ( $\frac{1}{4}$ ) to the survivor of the two said nieces, and if any two of the three shall then be dead, then the entire undistributed corpus and accumulated income, if any, shall be distributed to the survivor of the three. If all three shall predecease the said Beneficiary, then the undistributed corpus and accumulated net income, if any, shall be distributed to the then living heirs at law of the said Beneficiary, Patricia May Kenyon, determined according to the laws of California then in force relating to separate property, and thereupon this Trust shall cease and terminate.



(4) Upon the decease of the said Patricia May Kenyon, or after her death, upon the decease of any person receiving income from the Trust Estate, the Trustee shall pay out of income, if available, and if not available then out of principal, her or his last illness and burial expenses to the extent that these items shall not be paid by some other person or estate.

## ARTICLE II

POWERS OF THE TRUSTEE      To carry out the purposes of this Trust and subject to any limitations stated elsewhere in this Declaration, the Trustee is vested with the following powers, in addition to those now or hereafter conferred by law, affecting the Trust and the Trust Estate:

(1) To hold any property and operate any business received in this Trust as long as he may deem advisable.

(2) To manage, control, sell, convey, exchange, partition, divide, subdivide, improve, repair; to grant options and to sell upon deferred payments; to lease for terms within or extending beyond the duration of this Trust for any purpose, including exploration for and removal of gas, oil and other minerals; to create restrictions, easements and other servitudes.

(3) To compromise, arbitrate or otherwise adjust claims in favor of or against the Trust; to carry such insurance as the Trustee may deem advisable.

(4) To invest principal, and income if accumulated, in such bonds, mortgages, trust deeds, debentures, preferred or common stocks, or other property, real or personal, as the Trustee may deem advisable, whether or not authorized by law for the investment

of trust funds. The Trustee shall not be liable for any loss of principal or income which may result from the making of any such investments.

(5) To advance funds to this Trust for any trust purpose, such advances with interest at current rates to be a first lien on and to be repaid out of principal or income; to reimburse himself from principal or income for any loss or expense incurred by reason of his ownership or holding of any property in this Trust.

(6) To borrow money for any trust purpose upon such terms and conditions as the Trustee may deem proper, and to obligate the Trust Estate for repayment; to encumber the Trust Estate or any of its property by mortgage, deed of trust, pledge or otherwise, using such procedure to consummate the transaction as the Trustee may deem advisable.

(7) To have respecting securities all the rights, powers and privileges of an owner, including the power to give proxies, pay assessments and other sums deemed by the Trustee necessary for the protection of the Trust Estate; to participate in voting trusts, pooling agreements, foreclosures, reorganizations, consolidations, mergers and liquidations, and in connection therewith to deposit securities with and transfer title to any protective or other committee under such terms as the Trustee may deem advisable; to exercise or sell stock subscription or conversion rights; regardless of any limitations elsewhere in this instrument relative to investments by the Trustee, to accept and retain as an investment any securities or other property received through the exercise of any of the foregoing powers.

(8) Upon any division or partial or final distribution of the Trust Estate, to partition, allot and distribute the Trust Estate in undivided interests or in kind, or partly in money and partly in kind, at valuations determined by the Trustee, and to sell such property as the Trustee may deem necessary to make division or distribution.

(9) To budget the estimated annual income and expenses of the Trust in such manner as to equalize, as far as practicable, periodical income payments to beneficiaries.

(10) To determine what is principal or income of the Trust Estate and apportion and allocate in his discretion receipts and expenses as between these accounts.

(11) Unless specifically limited, all discretions conferred upon the Trustee shall be absolute and their exercise conclusive on all persons interested in this Trust. The enumeration of certain powers of the Trustee shall not limit his general powers, the Trustee being vested with and having all the rights, powers, and privileges which an absolute owner of the same property would have.

### ARTICLE III.

GENERAL PROVISIONS (1) Income accrued or unpaid on trust property when received into the trust shall be treated as any other income. Income accrued or held undistributed by the Trustee at the termination of any interest or estate under this Trust shall go to the beneficiaries entitled to the next eventual interest in the proportions in which they take such interest. Periodical payments out of principal,

not due upon the termination of any interest or estate, shall not be apportioned to that date. The Trustee shall not be required to prorate taxes and other current expenses to the date of termination.

(2) Until the Trustee shall receive written notice of any birth, marriage, death or other event upon which the right to payments from this Trust may depend, the Trustee shall incur no liability for disbursements made in good faith to persons whose interests may have been affected by that event.

(3) The Trustee may make payments to any beneficiary under disability by making them to the guardian of the person of the beneficiary or directly to the beneficiary, if a minor, or may apply them for the beneficiary's benefit.

SUCCESSOR (4) The Trustee shall have the right to  
TO TRUSTEE resign this Trusteeship at any time and to substitute a successor or successors by executing a written substitution; such substitution shall contain appropriate reference to this Declaration of Trust and the name of the new Trustee and the same shall be effective upon the signature of the Trustee and the acceptance in writing by the new Trustee, a copy of such substitution shall be delivered to or mailed to each beneficiary then entitled to receive income from the Trust Estate. From the time the substitution is signed, as aforesaid, the new Trustee shall succeed to all of the powers, duties, authority and title to the Trustee herein named. The procedure herein provided for substitution of Trustee shall be exclusive of all other provisions for substitution, statutory or otherwise.

MISCELLANEOUS (5) This Trust is irrevocable. The  
PROVISIONS Trustor may amend this Trust only in-  
sofar as it shall affect the powers,  
duties, and responsibilities of the Trustee, and may  
cancel or amend any such amendment. No amend-  
ment shall invest the Trustor with power to revoke  
this Trust in whole or in part, or to provide for any  
portion of the income to be distributed to or for the  
benefit of the Trustor, and no amendment shall be  
made which might result in a reverter or possibility  
of reverter of any portion of the corpus or income  
of the Trust Estate to the Trustor.

(6) If the Trustee shall be required to pay any  
gift or estate taxes in connection with this Trust,  
the same may be charged against income or principal  
or both as the Trustee in his sole discretion may de-  
termine is to the best interests of the Trust Estate.  
The Trust herein created shall, unless sooner ter-  
minated, by the distribution of all principal and ac-  
cumulated income as herein provided, expire and de-  
termine twenty-five (25) years after the date of this  
Trust. The situs of this Trust shall be the State of  
California and the same shall be construed according  
to the laws of the State of California.

(7) If any provision of this instrument is unen-  
forceable, the remaining provisions shall, nevertheless,  
be carried into effect.

(8) Other property acceptable to the Trustee may  
be added to this Trust.

EXECUTED this 8th day of August, 1941.

-----  
TRUSTEE

I certify that I have read the foregoing Declaration of Trust and approve the same in all particulars and request the Trustee to execute it.

.....  
TRUSTOR

I, Matilda R. Kenyon, wife of the Trustor, do hereby certify that the foregoing has been executed with my knowledge and consent.

.....



Joint Exhibit 5-E

MINUTES OF THE MEETING OF DIRECTORS  
OF  
CAPITOL CHEVROLET Co.

Held December 21, 1948

At a meeting of the Board of Directors of Capitol Chevrolet Co., a California corporation, held at 5117 Proctor, Oakland, California on December 21, 1948, the following members were present:

F. Norman Phelps

James A. Kenyon

Alice Phelps

being all of the Directors of this company. Mr. Phelps acted as Chairman of the meeting and Mrs. Phelps acted as Secretary thereof.

The minutes of the previous meeting were read and upon motion duly made and seconded were unanimously approved.

The President stated that the Chevrolet Division of General Motors Corporation had advised this corporation by letter that it would have to eliminate the Patricia May Kenyon Trust as a stockholder in order to maintain its franchise; that the policy of the Chevrolet Division was to require the shareholders of enfranchised corporations to be active in the business and that the continuation of said Trust as a stockholder contravened that policy. He stated further that in conversation with the Chevrolet Division of General Motors the Division had acknowledged the success achieved by Messrs. Phelps and Kenyon in their previous operations where control had been divided equally between them and it urged that the elimination of the Trust

be so achieved that control of this corporation thereafter remain equally divided between Messrs. Phelps and Kenyon. He said that in order to satisfy those requirements, the possible purchasers of the Trust's stock were necessarily limited to the present stockholders and the corporation; that no one of them was financially able at this time to purchase all of the Trust's stock and so much in addition as might be necessary to equalize the interests of Messrs. Phelps and Kenyon; that considerable study had been given to ways and means of satisfying the demands of the Chevrolet Division of General Motors Corporation within the latitude permitted by the finances of the stockholders and this corporation and that a plan had been informally agreed upon whereby the corporation would purchase from the Trust 130 shares at the book value thereof determined as of November 30, 1948 and that Mr. Kenyon would purchase from said Trust the remaining 40 shares; provided, however, that upon application duly made by Mr. Kenyon in his personal capacity the Superior Court having jurisdiction grants him permission to purchase said shares from the Trust; that in order to equalize stock ownership between Messrs. Kenyon and Phelps the corporation would thereafter purchase from F. Norman and Alice Phelps 130 shares, thus making the voting control equally divided between Messrs. Kenyon and Phelps. In the event that Mr. Kenyon is unable, upon application, to obtain court authorization for the purchase of the remaining 40 shares held by the Trust, then and in that event said shares will be purchased and retired by the corporation, and Mr. Kenyon will purchase from F. Norman and Alice Phelps 20 shares. After a general discussion of the foregoing, the following resolutions were unanimously adopted:

WHEREAS this corporation has been notified by the Chevrolet Division of General Motors Corporation

that it must eliminate the Patricia May Kenyon Trust as a stockholder of this corporation in order to maintain its franchise; and

WHEREAS this corporation has been further advised by the Chevrolet Division of General Motors Corporation that the voting control of this corporation should be equally divided between Messrs. Kenyon and Phelps; and

WHEREAS it is deemed to be to the best interests of this corporation that its stated capital be reduced from \$85,000 to \$59,000, upon its purchase of said 260 shares, or that it be reduced from \$85,000 to \$55,000 in the event that it is required to purchase 300 shares of said stock as more fully hereafter appears; and

WHEREAS the Board of Directors believe that the purchase of the stock of this corporation hereinafter referred to will not impair this corporation's ability to pay its debts and liabilities when they fall due; and

WHEREAS none of the stock outstanding of this corporation has liquidation preferences which may be prejudiced by this corporation's purchase of said stock; and

WHEREAS it is the opinion of the Board of Directors that the book value determined as of November 30, 1948 is also the fair market value of the stock of this corporation; and

WHEREAS the book value of one share of stock so determined as of November 30, 1948 is \$580.91;

NOW, THEREFORE, BE IT RESOLVED that the plan for the purchase and retirement by this corporation of 130 shares of this corporation's stock now held

by James Kenyon, Trustee for Patricia May Kenyon, for the purchase by James Kenyon of the remaining 40 shares held in said Trust, and for the purchase and retirement by this corporation of 130 shares from F. Norman and Alice Phelps, be and the same hereby is approved, it being understood that if court approval is not given to Mr. Kenyon to purchase the remaining 40 shares held by the Trust, then and in that event said 40 shares shall be purchased and retired by the corporation, and Mr. Kenyon will purchase from F. Norman and Alice Phelps 20 shares of stock.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized and directed to purchase out of earned surplus for and in behalf of this corporation 130 shares of this corporation's stock now held by James Kenyon, Trustee for Patricia May Kenyon Trust, for \$75,518.30.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized to purchase out of earned surplus for and in behalf of this corporation 130 shares of the stock now held by F. Norman Phelps and Alice Phelps for \$75,518.30.

BE IT FURTHER RESOLVED that in the event the Superior Court having jurisdiction refuses upon application to authorize the purchase by James Kenyon of 40 shares held by him as Trustee for Patricia May Kenyon, the officers and directors of this corporation be and the same hereby are directed to purchase said 40 shares for and in behalf of this corporation for \$23,236.40.

BE IT FURTHER RESOLVED that following the acquisition by this corporation of said shares of this

corporation's stock as detailed hereinabove, the officers and directors be and the same hereby are authorized to take such steps as may be necessary under Section 348 of the California Civil Code, to retire said shares and to accomplish a reduction of this corporation's stated capital from \$85,000 to \$59,000 in the event 260 of said shares are purchased or from \$85,000 to \$55,000 in the event 300 of said shares are purchased.

BE IT FURTHER RESOLVED that the officers of this corporation be and they hereby are authorized and directed to procure the approval of these resolutions by the vote or written consent of the holders of a majority of the outstanding shares of this corporation, regardless of limitations or restrictions of the voting rights thereof, and to take such further action as may be necessary and proper to effect the reduction of stated capital of this corporation, as hereinabove in these resolutions set forth and in accordance with the laws of the State of California.

After consideration and a general discussion of the corporation's financial statement, the following resolution was also unanimously adopted:

WHEREAS the purchase and redemption of stock according to the plan hereinabove set forth will reduce the corporation's working capital below its minimum requirements;

NOW, THEREFORE, BE IT RESOLVED that the officers of this corporation be and they hereby are authorized and directed to borrow, in behalf of this corporation, from such banks or trust companies as they may in their judgment determine, an amount not exceeding

\$200,000, for such period of time and upon such terms and rate of interest as may to them in their discretion seem advisable and to execute notes in respect thereto in the name of the corporation for the payment of the amount so borrowed.

Approved, ratified and confirmed by the Directors, this 21st day of December, 1948.

F. NORMAN PHELPS

F. Norman Phelps

JAMES A. KENYON

James A. Kenyon

ALICE PHELPS

Alice Phelps



## Joint Exhibit 6-F

### MINUTES OF THE MEETING OF THE BOARD OF DIRECTORS OF

MID-VALLEY CHEVROLET Co.

Held December 21, 1948

At a meeting of the Board of Directors of Mid-Valley Chevrolet Co., a California corporation, held at 5117 Proctor, in the City of Oakland, California on December 21, 1948, the following members were present:

F. Norman Phelps

James A. Kenyon

Absent:

James E. Carpenter

Mr. Phelps acted as Chairman of the meeting and Mr. Kenyon acted as Secretary thereof. The minutes of the previous meeting were read and upon motion duly made and seconded were unanimously approved.

The President stated that the Chevrolet Division of General Motors Corporation had advised this corporation by letter that it would have to eliminate the Patricia May Kenyon Trust as a stockholder in order to maintain its franchise; that the policy of the Chevrolet Division was to require the shareholders of enfranchised corporations to be active in the business and that the continuation of said Trust as a stockholder contravened that policy. He stated further that in conversations with him the Chevrolet Division had acknowledged the success achieved by Messrs. Phelps and Kenyon in their previous operations where control had been divided equally between them and it urged that the elimination of the Trust be so achieved that control of this corporation thereafter remain equally divided

between Messrs. Phelps and Kenyon. He said that in order to satisfy those requirements, the possible purchasers of the Trust's stock were necessarily limited to the present stockholders and the corporation; that no one of them was financially able at this time to purchase all of the Trust's stock and so much in addition as might be necessary to equalize the interests of Messrs. Phelps and Kenyon; that considerable study had been given to ways and means of satisfying the demands of the Chevrolet Division of General Motors Corporation within the latitude permitted by the finances of the stockholders and this corporation and that a plan had been informally agreed upon whereby the corporation would purchase from the Trust 130 shares at the book value thereof determined as of November 30, 1948 and that Mr. Kenyon would purchase from said Trust the remaining 40 shares; provided, however, that upon application duly made by Mr. Kenyon in his personal capacity the Superior Court having jurisdiction grants him permission to purchase said shares from the Trust; that in order to equalize stock ownership between Messrs. Kenyon and Phelps the corporation would thereafter purchase from F. Norman and Alice Phelps 130 shares, thus making the voting control equally divided between Messrs. Kenyon and Phelps. In the event that Mr. Kenyon is unable, upon application, to obtain court authorization for the purchase of the remaining 40 shares held by the Trust, then and in that event said shares will be purchased and retired by the corporation, and Mr. Kenyon will purchase from F. Norman and Alice Phelps 20 shares. After a general discussion of the foregoing, the following resolutions were unanimously adopted:

WHEREAS this corporation has been notified by the Chevrolet Division of General Motors Corporation

that it must eliminate the Patricia May Kenyon Trust as a stockholder of this corporation in order to maintain its franchise; and

WHEREAS this corporation has been further advised by the Chevrolet Division of General Motors Corporation that the voting control of this corporation should be equally divided between Messrs. Kenyon and Phelps; and

WHEREAS it is deemed to be the best interests of this corporation that its stated capital be reduced from \$85,000 to \$59,000, upon its purchase of said 260 shares, or that it be reduced from \$85,000 to \$55,000 in the event that it is required to purchase 300 shares of said stock as more fully hereafter appears; and

WHEREAS the Board of Directors believe that the purchase of the stock of this corporation hereinafter referred to will not impair this corporation's ability to pay its debts and liabilities when they fall due; and

WHEREAS none of the stock outstanding of this corporation has liquidation preferences which may be prejudiced in this corporation's purchase of said stock; and

WHEREAS it is the opinion of the Board of Directors that the book value determined as of November 30, 1948 is also the fair market value of the stock of this corporation; and

WHEREAS the book value of one share of stock so determined as of November 30, 1948 is \$571.85;

NOW, THEREFORE, BE IT RESOLVED that the plan for the purchase and retirement by this corporation of 130 shares of this corporation's stock now held

by James Kenyon, Trustee for Patricia May Kenyon, for the purchase by James Kenyon of the remaining 40 shares held in said Trust, and for the purchase and retirement by this corporation of 130 shares from F. Norman and Alice Phelps, be and the same hereby is approved, it being understood that if court approval is not given to Mr. Kenyon to purchase the remaining 40 shares held by the Trust, then and in that event said 40 shares shall be purchased and retired by the corporation, and Mr. Kenyon will purchase from F. Norman and Alice Phelps 20 shares of stock.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized and directed to purchase out of earned surplus for and in behalf of this corporation 130 shares of this corporation's stock now held by James Kenyon, Trustee for Patricia May Kenyon Trust, for \$74,340.50.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized to purchase out of earned surplus for and in behalf of this corporation 130 shares of the stock now held by F. Norman Phelps and Alice Phelps for \$74,340.50.

BE IT FURTHER RESOLVED that in the event the Superior Court having jurisdiction refuses upon application to authorize the purchase by James Kenyon of 40 shares held by him as Trustee for Patricia May Kenyon, the officers and directors of this corporation be and the same hereby are directed to purchase said 40 shares for and in behalf of this corporation for \$22,874.00.

BE IT FURTHER RESOLVED that following the acquisition by this corporation of said shares of this cor-

poration's stock as detailed hereinabove, the officers and directors be and the same hereby are authorized to take such steps as may be necessary under Section 348 of the California Civil Code, to retire said shares and to accomplish a reduction of this corporation's stated capital from \$85,000 to \$59,000 in the event 260 of said shares are purchased or from \$85,000 to \$55,000 in the event 300 of said shares are purchased.

BE IT FURTHER RESOLVED that the officers of this corporation be and they hereby are authorized and directed to procure the approval of these resolutions by the vote or written consent of the holders of a majority of the outstanding shares of this corporation, regardless of limitations or restrictions of the voting rights thereof, and to take such further action as may be necessary and proper to effect the reduction of stated capital of this corporation, as hereinabove in these resolutions set forth and in accordance with the laws of the State of California.

After consideration and a general discussion of the corporation's financial statement, the following resolution was also unanimously adopted:

WHEREAS the purchase and redemption of stock according to the plan hereinabove set forth will reduce the corporation's working capital below its minimum requirements;

NOW, THEREFORE, BE IT RESOLVED that the officers of this corporation be and they hereby are authorized and directed to borrow, in behalf of this corporation, from such banks or trust companies as they may in their judgment determine, an amount not exceeding

\$200,000, for such period of time and upon such terms and rate of interest as may to them in their discretion seem advisable and to execute notes in respect thereto in the name of the corporation for the payment of the amount so borrowed.

Approved, ratified and confirmed by the Directors, this 21st day of December, 1948.

F. NORMAN PHELPS

F. Norman Phelps

JAMES A. KENYON

James A. Kenyon



## Joint Exhibit 7-G

### MINUTES OF THE MEETING OF THE BOARD OF DIRECTORS OF

HOWELL CHEVROLET Co.

Held December 21, 1948

At a meeting of the Board of Directors of Howell Chevrolet Co., a California corporation, held at 5117 Proctor in the City of Oakland, California on December 21, 1948, the following members were present:

F. Norman Phelps

James A. Kenyon

Absent:

Jackson Howell

Mr. Phelps acted as Chairman and Mr. Kenyon acted as Secretary of the meeting.

The Secretary presented and read to the meeting a written Waiver of Notice thereof signed by all the Directors.

The minutes of the previous meeting were read and upon motion duly made and seconded were unanimously approved.

The President stated that the Chevrolet Division of General Motors Corporation had advised this corporation by letter that it would have to eliminate the Patricia May Kenyon Trust from stock ownership in the corporation in order for this corporation to retain its franchise; that the policy of the Chevrolet Division was to require the stockholders of enfranchised corporations to be active in the business and that the continuation of said Trust as a stockholder contravened that policy. He said that representatives of the Chevrolet Division had orally indicated that in view of the corporation's past success under own-

ership where the voting control of the corporation was equally divided among Messrs. Phelps, Kenyon and Howell there was no desire on its part to disturb that allocation; rather it thought it desirable that the elimination of the Trust be so accomplished that voting control of the corporation repose where it had prior to the elimination of the Trust. He said that in order to satisfy those requirements, the possible purchasers of the stock now held by the Trust were necessarily limited to the other present stockholders and the corporation; that Mr. Kenyon had advised him that he was not financially able to purchase all of the stock held by the Trust but that he could purchase some of it if he could obtain the necessary court approval; that in view of this and after considerable study of ways and means of satisfying the demands made by the Chevrolet Division, a plan had been informally agreed upon whereby the corporation would purchase from the Trust 100 shares of this corporation's stock, another 100 shares from Mr. Howell and an additional 100 shares from F. Norman and Alice Phelps. At the same time Mr. Kenyon would purchase 20 shares from the Trust, with the end result that after these purchases were made, Messrs. Phelps, Kenyon and Howell would each have voting control of 200 shares of the stock of this corporation. It is contemplated that the plan will be carried out as stated hereinabove. However, Mr. Kenyon must obtain authorization from the Superior Court of the State of California to purchase said 20 shares from the Trust of which he is trustee. In the event that he is denied such authority, then it is understood that the corporation will purchase from the Trust said 20 remaining shares and in that event F. Norman and Alice Phelps will sell to Mr. Kenyon  $6\frac{2}{3}$  shares, and Jackson Howell will likewise sell to Mr. Ken-

yon  $6\frac{2}{3}$  shares. After a general discussion of the foregoing, the following resolutions were unanimously adopted:

WHEREAS this corporation has been notified by the Chevrolet Division of General Motors Corporation that it must eliminate the Patricia May Kenyon Trust as a stockholder of this corporation in order to retain its franchise; and

WHEREAS this corporation has been further advised by the Chevrolet Division of General Motors Corporation that the voting control of this corporation should remain equally distributed among Messrs. Phelps, Kenyon and Howell; and

WHEREAS there are now outstanding 900 shares of \$100 par value common stock; and

WHEREAS the stated capital of this corporation is \$90,000; and

WHEREAS the Board of Directors believe that the purchase of the stock of this corporation hereinafter referred to will not impair this corporation's ability to pay its debts and liabilities when they fall due; and

WHEREAS none of the stock outstanding of this corporation has liquidation preferences which may be prejudiced by this corporation's purchase of said stock; and

WHEREAS the book value of one share of stock of this corporation determined as of November 30, 1948 is \$465.08; and

WHEREAS it is the opinion of the Board of Directors that said book value is also the fair market value of said stock; and

WHEREAS it is deemed to the best interests of this corporation that its stated capital be reduced from

\$90,000 to \$60,000 upon its purchase of said 300 shares of stock, or in the event that Mr. Kenyon is unable to obtain authority to purchase 20 shares of this corporation's stock from the Patricia May Kenyon Trust and this corporation, by reason thereof, is then required to purchase 320 shares of said stock, that the stated capital then be reduced from \$90,000 to \$58,000.

NOW, THEREFORE, BE IT RESOLVED that the plan for the purchase and retirement by this corporation of 100 shares of its common capital stock from the Patricia May Kenyon Trust of 100 shares from Jackson Howell and of 100 shares of said stock from F. Norman and Alice Phelps, together with the concurrent purchase by James A. Kenyon of 20 shares of said stock from the Patricia May Kenyon Trust, be and the same hereby is approved, it being understood that if James A. Kenyon is denied authority by the Superior Court to purchase said 20 shares, that then and in that event the corporation will purchase said shares and F. Norman and Alice Phelps will sell to James A. Kenyon  $6\frac{2}{3}$  shares, as will Jackson Howell.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized and directed to purchase out of earned surplus for and in behalf of this corporation 100 shares of this corporation's common capital stock now held by James A. Kenyon, Trustee for Patricia May Kenyon Trust, for \$46,508.00.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized to purchase out of earned surplus for and in behalf of

this corporation 100 shares of this corporation's common capital stock from Jackson Howell for \$46,508.

BE IT FURTHER RESOLVED that the officers and directors, or any of them, is hereby authorized to purchase out of earned surplus for and in behalf of this corporation 100 shares of this corporation's common capital stock from F. Norman and Alice Phelps for \$46,508.

BE IT FURTHER RESOLVED that in the event the Superior Court having jurisdiction refuses, upon application, to authorize the purchase by James Kenyon of 20 shares held by him as Trustee for Patricia May Kenyon, the officer and directors of this corporation, or any of them, is hereby authorized and directed to purchase said 20 shares for and in behalf of this corporation for \$9,316.

BE IT FURTHER RESOLVED that following the acquisition by this corporation of said shares of this corporation's stock, as detailed hereinabove, the officers and directors be and the same hereby are authorized to take such steps as may be necessary under Section 348 of the California Civil Code to retire said shares and to accomplish a reduction of this corporation's stated capital from \$90,000 to \$60,000 in the event that the corporation purchases 300 shares of said stock, or from \$90,000 to \$58,000 in the event that this corporation purchases 320 of said shares.

BE IT FURTHER RESOLVED that the officers of this corporation be, and they hereby are authorized and directed to procure the approval of these resolutions by the vote or written consent of the holders of a majority of the outstanding shares of this corpora-



tion, regardless of limitations or restrictions of the voting rights thereof, and to take such further action as may be necessary and proper to effect the reduction of stated capital of this corporation, as hereinabove in these resolutions set forth and in accordance with the laws of the State of California.

After consideration and a general discussion of the corporation's financial statement, the following resolution was also unanimously adopted:

WHEREAS the purchase and redemption of stock according to the plan hereinabove set forth will reduce the corporation's working capital below its minimum requirements;

NOW, THEREFORE, BE IT RESOLVED that the officers of this corporation be and they hereby are authorized and directed to borrow, in behalf of this corporation, from such banks or trust companies as they may in their judgment determine, an amount not exceeding \$200,000, for such period of time and upon such terms and rate of interest as may to them in their discretion seem advisable and to execute notes in respect thereto in the name of the corporation for the payment of the amount so borrowed.

Approved, ratified and confirmed by the Directors this 21 day of December, 1948.

F. NORMAN PHELPS

F. Norman Phelps

JAMES A. KENYON

James A. Kenyon



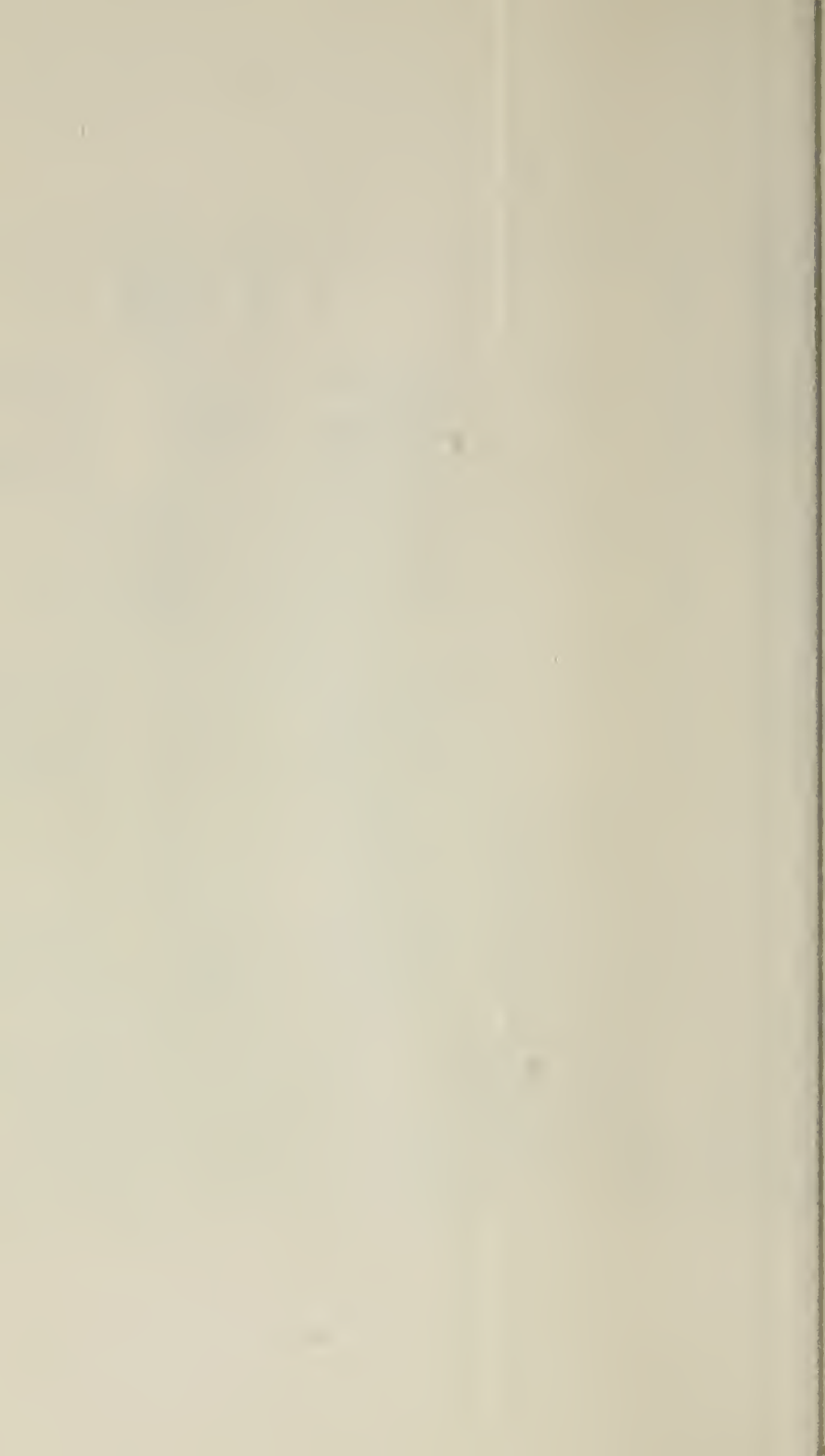
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1. Total deductions for tax liability charged to earned surplus during the taxable year:			
(a) Cash.			
(b) Stock of the corporation.			
(c) Other property.			
(d) Total. (Sum of lines 1 through 4.)			
2. Net income from operations less 5 percent limitation.			
3. Federal income and excess profits tax.			
4. State income and excess profits tax.			
5. State possessions if claimed as a credit in lieu of income tax.			
6. Federal income tax on dividends received.			
7. Replacement, renewal, and capital expenditures.			
8. Insurance premiums paid on the life of any officer or shareholder.			
9. Unrecoverable interest incurred in purchase or redemption of indebtedness.			
10. Excess of capital losses over capital gains.			
11. Additions to surplus reserve (list separately):			
(a) _____			
(b) _____			
(c) _____			
12. Other nonexcludable deductions:			
(a) _____			
(b) _____			
(c) _____			
13. Adjustments for tax purposes not recited on Form 1041:			
(a) _____			
(b) _____			
(c) _____			
14. Summary of adjustments:			
(a) Excess of capital losses over capital gains.			
(b) Opening New Branch.			
(c) _____			
15. Excess surplus and undistributed profits as shown on Schedule L at close of the taxable year.			
16. Total of lines 1 to 15.			

77 94

\$ 127,248.62

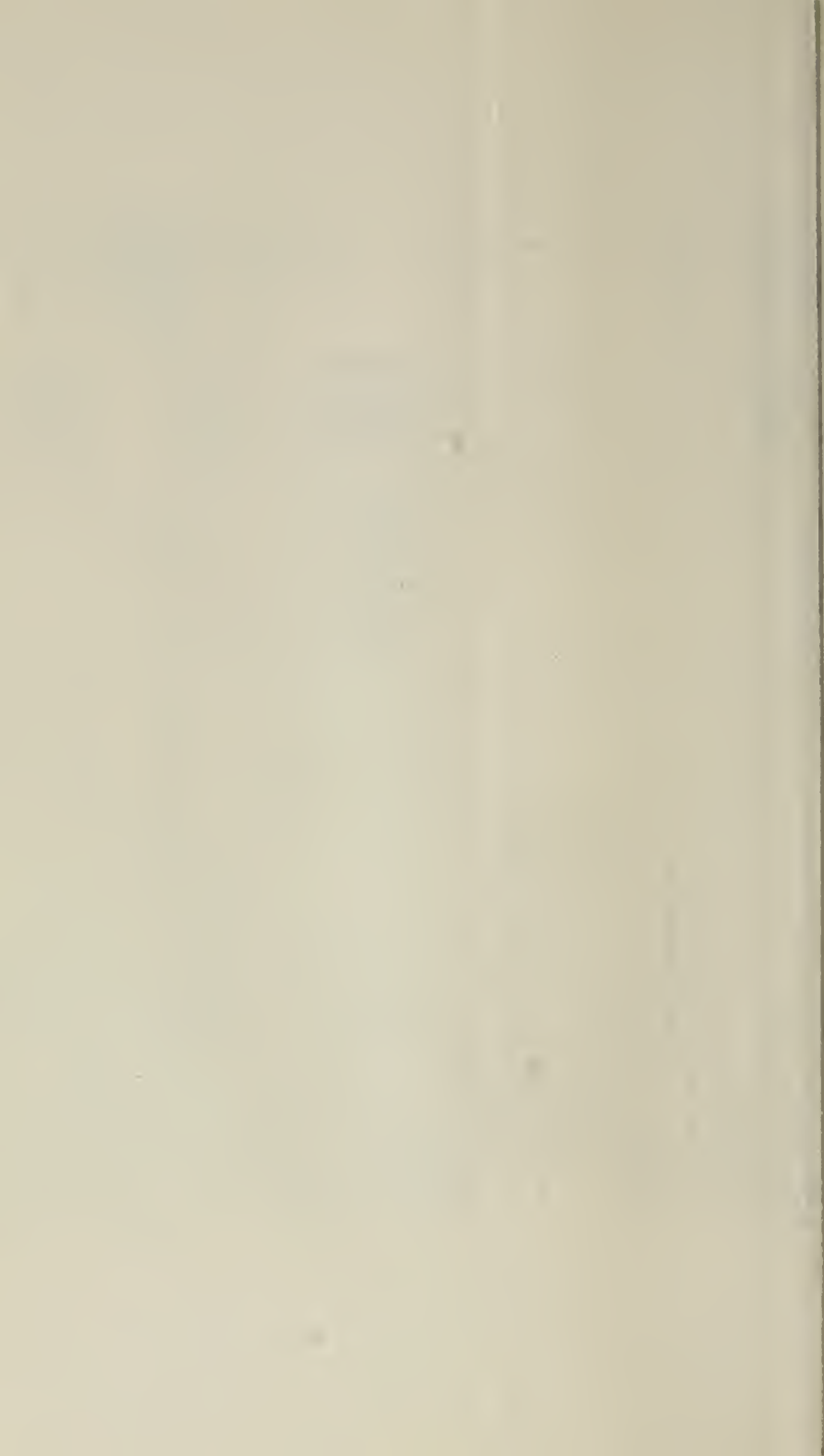
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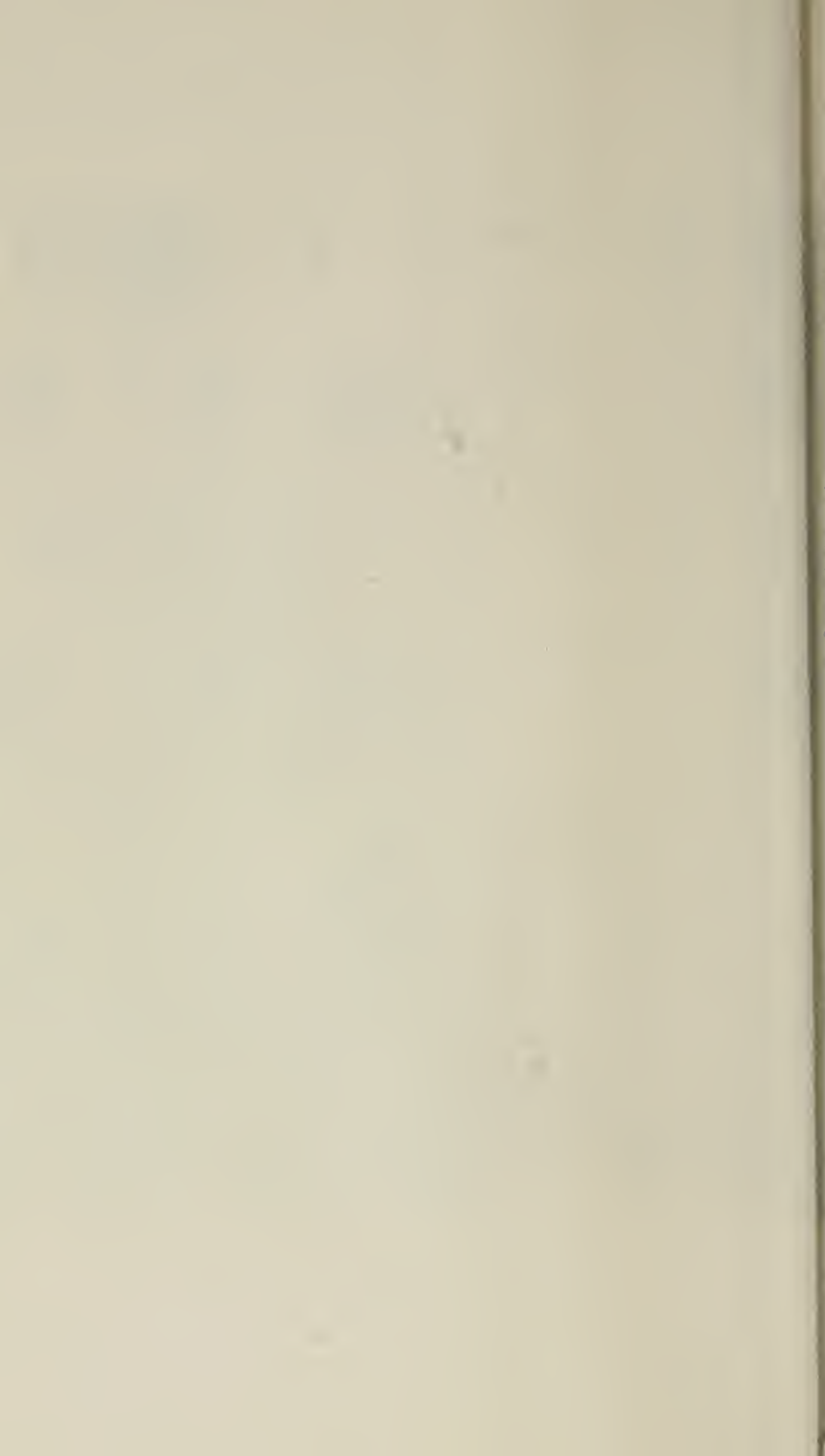
83, 27,170 52

Adjusted net income (item 15)

Page 1



2. Notes and accounts receivable:		\$ 29,378.91	\$ 26,292.12	\$ 132,935.11	\$ 132,117.10
Less: Allowance for bad debts:		3,086.79			
<b>3. Inventories:</b>					
(a) Raw materials:					
(b) Work in process:					
(c) Finished goods:					
(d) Supplies:					
<b>4. Investments in governmental entities:</b>					
(a) Federal bonds:					
(b) State bonds:					
(c) Municipal bonds:					
(d) Other securities:					
(e) Other investments:					
(f) Other assets:					
<b>5. Other investments (itemize):</b>					
<b>6. Capital assets:</b>					
(a) Depreciable assets (itemize):					
(b) Land:					
(c) Other assets (itemize):					
<b>7. Other assets (itemize):</b>					
<b>8. Total Assets:</b>					
<b>9. Liabilities:</b>					
(a) Accounts payable:					
(b) Bonds, notes, and mortgages payable:					
(c) With original maturity of 1 year or more:					
(d) Other liabilities (itemize):					
<b>10. Bonus Fund - 14c - Taxes:</b>					
<b>11. Capital stock:</b>					
(a) Preferred stock:					
(b) Common stock:					
<b>12. Paid-in or capital surplus:</b>					
(a) Surplus and undivided profits:					
<b>13. Total Liabilities:</b>					
<b>Schedule M—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS</b>					
<b>1. Total distributions to stockholders (change to earned surplus during the taxable year):</b>					
(a) Cash:					
(b) Stock of the corporation:					
(c) Contributions or gifts (excess over 5 percent limitation):					
(d) Federal income tax excess profit tax (United States provision if claimed as a credit in the taxable year):					
(e) Federal taxes paid on tax-free government bonds:					
(f) Special improvement taxes (adding to increase the value of the property acquired):					
(g) Repurchases, forwards, and capital expenditures:					
(h) Insurance premiums paid on the life of an officer or director (or indirectly a beneficiary):					
(i) Unearned surplus (unearned income):					
(j) Excess of capital losses over capital gain:					
(k) Additions to surplus reserves (less withdrawals):					
(l) Other:					
<b>2. Other non-taxable income (itemize):</b>					
(a) State tax add:					
(b) Other:					
<b>3. Adjustments for tax purposes not recorded on books (itemize):</b>					
(a) Deprec. Adj.:					
(b) Other:					
<b>4. Surplus debits to earned surplus (itemize):</b>					
(a) Other:					
<b>5. Earned surplus and undivided profits as shown on books (itemize):</b>					
(a) Total of lines 1 to 15:					
(b) Total of lines 17 to 23:					
<b>6. Total of lines 1 to 23:</b>					



1. Cash	\$ 136,026 15	\$ 102,709 91
2. Notes and accounts receivable	\$ 332,915 11	\$ 359,454 77
Less: Reserve for bad debts	498 31	1,720 33
3. Inventories:		
(a) Raw materials		
(b) Work in process		
(c) Finished goods		
4. Investments in governmental obligations:		
(a) U.S. Government bonds		
(b) U.S. Government notes		
(c) U.S. Government bonds, 1977-1981		
(d) U.S. Government bonds, 1981-1985		
(e) U.S. Government bonds, 1985-1990		
(f) U.S. Government bonds, 1990-1995		
(g) U.S. Government bonds, 1995-2000		
(h) U.S. Government bonds, 2000-2005		
(i) U.S. Government bonds, 2005-2010		
(j) U.S. Government bonds, 2010-2015		
(k) U.S. Government bonds, 2015-2020		
(l) U.S. Government bonds, 2020-2025		
(m) U.S. Government bonds, 2025-2030		
(n) U.S. Government bonds, 2030-2035		
(o) U.S. Government bonds, 2035-2040		
(p) U.S. Government bonds, 2040-2045		
(q) U.S. Government bonds, 2045-2050		
(r) U.S. Government bonds, 2050-2055		
(s) U.S. Government bonds, 2055-2060		
(t) U.S. Government bonds, 2060-2065		
(u) U.S. Government bonds, 2065-2070		
(v) U.S. Government bonds, 2070-2075		
(w) U.S. Government bonds, 2075-2080		
(x) U.S. Government bonds, 2080-2085		
(y) U.S. Government bonds, 2085-2090		
(z) U.S. Government bonds, 2090-2095		
(aa) U.S. Government bonds, 2095-2100		
5. Other investments (net assets)		
6. Capital assets:		
(a) Depreciable assets (net assets)		
(b) Land		
(c) Buildings		
(d) Equipment		
(e) Vehicles		
(f) Furniture		
(g) Other		
7. Other assets (net assets)		
(a) Land		
(b) Buildings		
(c) Equipment		
(d) Vehicles		
(e) Furniture		
(f) Other		
8. Total Assets		
9. Accounts payable		
10. Bonds		
11. Accrued expenses (net assets)		
12. Other liabilities (net assets)		
13. Surplus reserves (net assets)		
14. Capital stock:		
(a) Preferred stock		
(b) Common stock		
15. Paid-in or capital surplus		
16. Earned surplus and undivided profits		
17. Total Liabilities		

1. Total distribution to stockholders (change of equity)	\$ 285,853 04	\$ 285,853 04
2. Contributions or gifts (over 5 percent)		
3. Federal income and excess profits taxes		
4. Income taxes of foreign countries or United States (over 5 percent)		
5. Federal taxes paid on tax-free covenant bonds		
6. Federal taxes paid on tax-free covenant bonds		
7. Federal taxes paid on tax-free covenant bonds		
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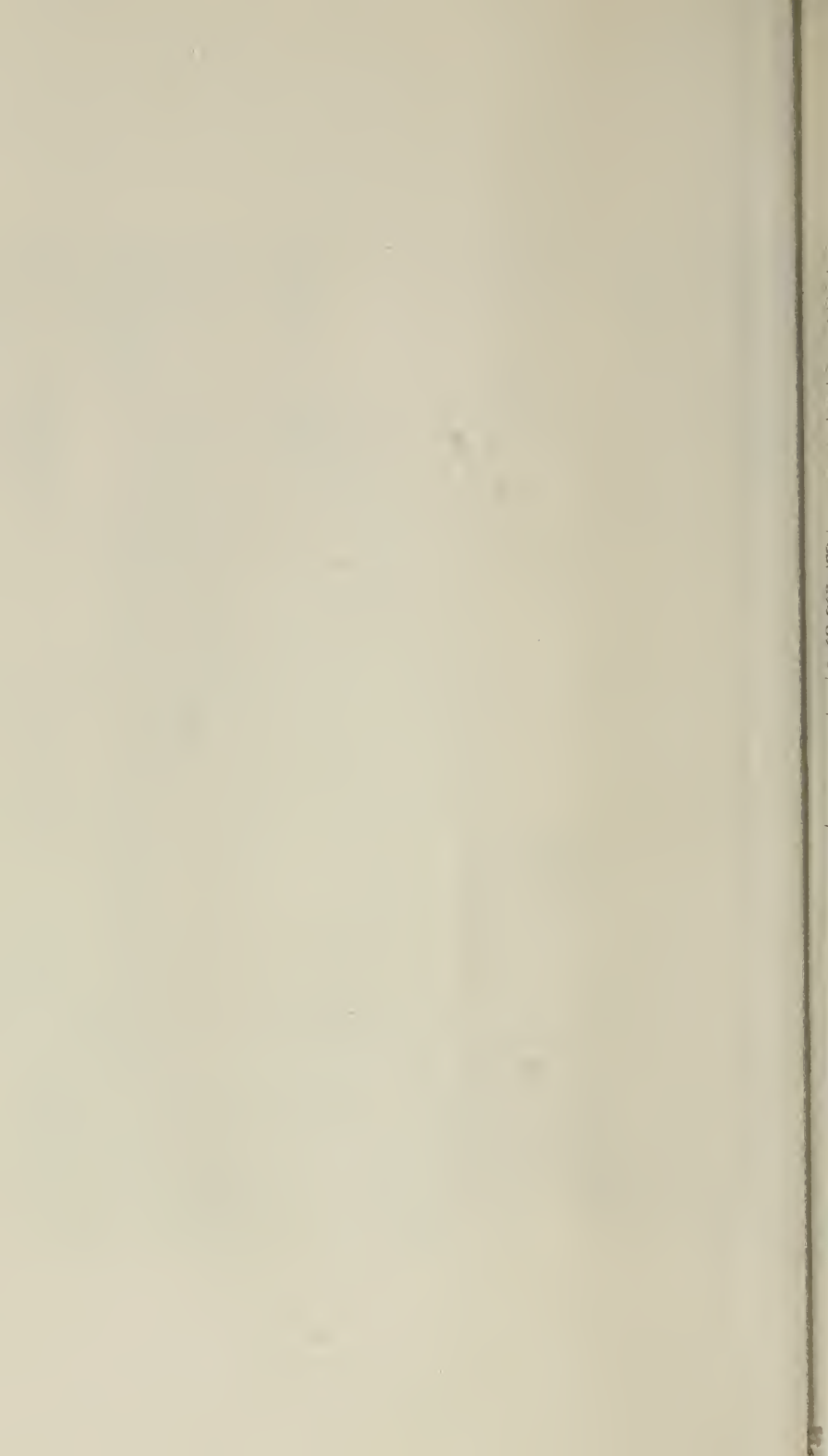




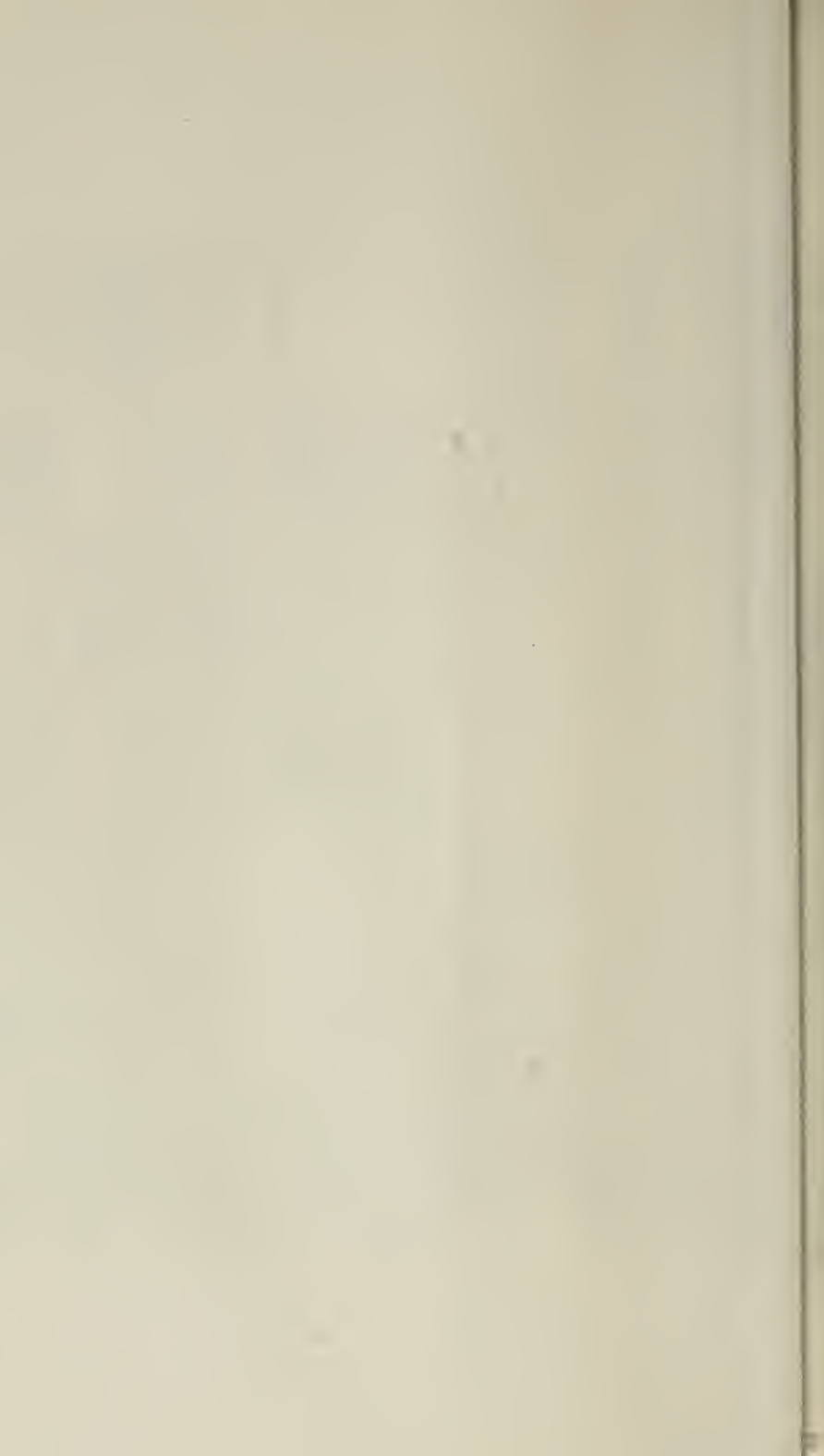
Assets	Total	Assets	Total	Assets	Total
1. Cash	\$ 10,747.85				
2. Notes and accounts receivable	\$ 13,559.57				
3. Income tax receivable for last year	\$ 2,222.29				
4. Total	\$ 26,539.71				
5. Inventory	\$ 177,655.70				
6. Capital assets					
(a) Depreciable assets (see Part II, Section 1601)	\$ 16,977.20				
(b) Land	\$ 11,588.77				
(c) Buildings and fixtures	\$ 11,097.61				
(d) Furniture and fixtures	\$ 5,412.11				
(e) Total depreciable assets	\$ 23,075.69				
(f) Land	\$ 11,588.77				
(g) Total capital assets	\$ 34,664.46				
7. Other assets (see Part II, Section 1602)	\$ 18,111.90				
8. Total assets	\$ 181,210.20				
9. Liabilities	\$ 331,734.66				
10. Accounts payable	\$ 80,043.68				
11. Bonds, notes, and mortgages payable					
(a) With original maturity of less than 1 year	\$ 1,027.79				
(b) With original maturity of 1 year or more	\$ 7,674.19				
12. Accrued expenses (see Part II, Section 1603)	\$ 3,492.55				
13. Other liabilities (see Part II, Section 1604)	\$ 101,154.18				
14. Surplus reserves (see Part II, Section 1605)					
(a) Capital stock	\$ 85,000.00				
(b) Common stock	\$ 85,000.00				
15. Paid-in or capital surplus	\$ 85,000.00				
16. Excess surplus and undivided profits	\$ 75,299.01				
17. Total liabilities	\$ 381,734.66				

## Schedule M—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total net income (see Part II, Section 1601)	\$ 121,406.80
2. Total deductions (see Part II, Section 1602)	\$ 121,406.80
3. Total net income (see Part II, Section 1601)	\$ 121,406.80
4. Total deductions (see Part II, Section 1602)	\$ 121,406.80
5. Total net income (see Part II, Section 1601)	\$ 121,406.80
6. Total deductions (see Part II, Section 1602)	\$ 121,406.80
7. Total net income (see Part II, Section 1601)	\$ 121,406.80
8. Total deductions (see Part II, Section 1602)	\$ 121,406.80
9. Total net income (see Part II, Section 1601)	\$ 121,406.80
10. Total deductions (see Part II, Section 1602)	\$ 121,406.80
11. Total net income (see Part II, Section 1601)	\$ 121,406.80
12. Total deductions (see Part II, Section 1602)	\$ 121,406.80
13. Total net income (see Part II, Section 1601)	\$ 121,406.80
14. Total deductions (see Part II, Section 1602)	\$ 121,406.80
15. Total net income (see Part II, Section 1601)	\$ 121,406.80
16. Total deductions (see Part II, Section 1602)	\$ 121,406.80
17. Total net income (see Part II, Section 1601)	\$ 121,406.80
18. Total deductions (see Part II, Section 1602)	\$ 121,406.80
19. Total net income (see Part II, Section 1601)	\$ 121,406.80
20. Total deductions (see Part II, Section 1602)	\$ 121,406.80
21. Total net income (see Part II, Section 1601)	\$ 121,406.80
22. Total deductions (see Part II, Section 1602)	\$ 121,406.80
23. Total net income (see Part II, Section 1601)	\$ 121,406.80
24. Total deductions (see Part II, Section 1602)	\$ 121,406.80
25. Total net income (see Part II, Section 1601)	\$ 121,406.80
26. Total deductions (see Part II, Section 1602)	\$ 121,406.80
27. Total net income (see Part II, Section 1601)	\$ 121,406.80
28. Total deductions (see Part II, Section 1602)	\$ 121,406.80
29. Total net income (see Part II, Section 1601)	\$ 121,406.80
30. Total deductions (see Part II, Section 1602)	\$ 121,406.80
31. Total net income (see Part II, Section 1601)	\$ 121,406.80
32. Total deductions (see Part II, Section 1602)	\$ 121,406.80
33. Total net income (see Part II, Section 1601)	\$ 121,406.80
34. Total deductions (see Part II, Section 1602)	\$ 121,406.80
35. Total net income (see Part II, Section 1601)	\$ 121,406.80
36. Total deductions (see Part II, Section 1602)	\$ 121,406.80
37. Total net income (see Part II, Section 1601)	\$ 121,406.80
38. Total deductions (see Part II, Section 1602)	\$ 121,406.80
39. Total net income (see Part II, Section 1601)	\$ 121,406.80
40. Total deductions (see Part II, Section 1602)	\$ 121,406.80
41. Total net income (see Part II, Section 1601)	\$ 121,406.80
42. Total deductions (see Part II, Section 1602)	\$ 121,406.80
43. Total net income (see Part II, Section 1601)	\$ 121,406.80
44. Total deductions (see Part II, Section 1602)	\$ 121,406.80
45. Total net income (see Part II, Section 1601)	\$ 121,406.80
46. Total deductions (see Part II, Section 1602)	\$ 121,406.80
47. Total net income (see Part II, Section 1601)	\$ 121,406.80
48. Total deductions (see Part II, Section 1602)	\$ 121,406.80
49. Total net income (see Part II, Section 1601)	\$ 121,406.80
50. Total deductions (see Part II, Section 1602)	\$ 121,406.80
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87. Total net income (see Part II, Section 1601)	\$ 121,406.80
88. Total deductions (see Part II, Section 1602)	\$ 121,406.80
89. Total net income (see Part II, Section 1601)	\$ 121,406.80
90. Total deductions (see Part II, Section 1602)	\$ 121,406.80
91. Total net income (see Part II, Section 1601)	\$ 121,406.80
92. Total deductions (see Part II, Section 1602)	\$ 121,406.80
93. Total net income (see Part II, Section 1601)	\$ 121,406.80
94. Total deductions (see Part II, Section 1602)	\$ 121,406.80
95. Total net income (see Part II, Section 1601)	\$ 121,406.80
96. Total deductions (see Part II, Section 1602)	\$ 121,406.80
97. Total net income (see Part II, Section 1601)	\$ 121,406.80
98. Total deductions (see Part II, Section 1602)	\$ 121,406.80
99. Total net income (see Part II, Section 1601)	\$ 121,406.80
100. Total deductions (see Part II, Section 1602)	\$ 121,406.80



1. Cash	\$ 135,559 57	\$ 10,649 86	\$ 221,374 30	\$ 75,443 74
2. Notes and accounts receivable	2,222 29	133,337 28	932 24	226,442 06
3. Inventories:				
(a) Raw materials				
(b) Work in process				
(c) Finished goods				
(d) Supplies		177,655 70		286,567 42
4. Investments in governmental obligations:				
(a) United States bonds and Federal land bank stock				
(b) United States bonds and Federal land bank stock, maturing prior to March 1, 1941				
(c) United States bonds and Federal land bank stock, maturing after March 1, 1941				
(d) Federal land bank stock				
(e) Federal land bank stock, maturing prior to March 1, 1941				
(f) Federal land bank stock, maturing after March 1, 1941				
(g) Other investments in Federal land bank stock				
(h) Other investments in Federal land bank stock, maturing prior to March 1, 1941				
(i) Other investments in Federal land bank stock, maturing after March 1, 1941				
5. Other assets (itemize):				
(a) Land				
(b) Buildings				
(c) Equipment				
(d) Prepaid insurance				
(e) Other assets				
6. Capital assets: Machine & Shop Equip:				
(a) Depreciable assets (itemize):				
Machinery	16,727 20		19,703 77	
Furniture and fixtures	11,858 77		12,985 23	
Service cars	11,097 81		12,985 23	
Total depreciable assets	39,683 78		45,674 23	
(b) Dupl. assets	26,221 49	25,250 62	26,026 29	35,221 63
(c) Land				
(d) Buildings				
(e) Equipment				
(f) Prepaid insurance				
(g) Other assets				
7. Other assets (itemize):				
(a) Land				
(b) Buildings				
(c) Equipment				
(d) Prepaid insurance				
(e) Other assets				
8. Total Assets				
9. Accounts payable				
10. Bonds, notes, and mortgages payable:				
(a) With original maturity of less than 1 year				
(b) With original maturity of 1 year or more				
11. Accrued expenses (itemize):				
(a) Salaries				
(b) Other liabilities (itemize)				
12. Surplus reserves (itemize)				
13. Capital stock:				
(a) Preferred stock				
(b) Common stock				
14. Paid-in or capital surplus				
15. Earned surplus and undivided profits				
16. Total Liabilities				
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ASSETS		Liabilities and Equity, 1948	
		1948	1947
1. Cash	\$ 227,374 30	\$ 75,443 74	\$ 97,423 07
2. Notes and accounts receivable	932 24	226,442 06	242,769 95
3. Inventories:			612 28
(a) Raw materials			
(b) Finished goods			
(c) Supplies		256,567 42	256,541 90
4. Investments in governmental obligations			
(a) Federal bonds			
(b) State bonds			
(c) Municipal bonds			
(d) Corporate bonds			
(e) Other investments			
5. Other investments (itemize)			
(a) Real estate			
(b) Stocks			
(c) Bonds			
(d) Other investments			
6. Capital assets			
(a) Depreciable assets (itemize)			
(b) Land			
(c) Buildings			
(d) Equipment			
(e) Other capital assets			
7. Other assets (itemize)			
(a) Prepaid insurance			
(b) Other assets			
8. Total Assets			
9. Accounts payable			
10. Bonds, notes, and mortgages payable			
(a) With original maturity of less than 1 year			
(b) With original maturity of 1 year or more			
11. Accrued expenses (itemize)			
(a) Salaries and wages			
(b) Other accrued expenses			
12. Other liabilities (itemize)			
(a) Accounts payable			
(b) Notes payable			
(c) Other liabilities			
13. Surplus reserves (itemize)			
(a) Capital stock			
(b) Preferred stock			
(c) Common stock			
14. Excess surplus and undivided profits			
15. Total Liabilities			
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